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The Court of Appeal confirms that the word "producible" does not mean actual production

By Nigel Bankes

Cases Considered:

Bearspaw Petroleum Ltd v Encana Corporation, 2011 ABCA 7

The Court of Appeal in a memorandum of judgement (Rowbotham, McDonald and Bielby JJA) has confirmed Justice McMahon's decision at trial which I blogged here. See that post for a summary of the facts.

There were two issues in this case: (1) the proper interpretation of the habendum (duration) of a petroleum and natural gas lease, and (2) the existence of a covenant to market. The Court finds for the lessee (Bearspaw) on both grounds.

The proper interpretation of the habendum

In this case the petroleum and natural gas lease at issue provided a primary term of 10 years and a secondary term of "so long thereafter as the leased substances or any of them are *producible* from the leased area". The lessee had discovered reserves in economic quantities but it had not yet got around to tying those reserves in by pipeline. But that, held the Court, was sufficient to bring its activities within the secondary term of this lease. The parties to a lease are entitled to set the duration of the lease by reference to something other than production and (at para. 30) "that is what occurred here through the use of the word 'producible'." The trial judge did make one error which was (at para. 31) "to use as an interpretive aide the fact that the Appellant's predecessor in title took no action to terminate the lease for 22 years, from 1973 to 1995, when there was no production at all." The trial judge could not do that absent a finding of inconsistency between the different clauses of the lease (which had not been found in this case). But this error was not fatal since it did not change Justice McMahon's conclusion.

Justice McMahon's interpretation respected the ordinary and natural meaning of the words of the contract; it did not result in an absurdity and it did not defeat the intentions of the parties in entering into a commercial relationship.

The existence of a covenant to market

The lease contained an express clause dealing with the development of the lands in question.

> If and when production is found in commercial quantity in any well drilled on the leased area, the Lessee will continue with *reasonable diligence* to drill for and develop the property so as *to produce the leased substances in paying quantities*

> upon the entire tract, *having regard* at all times to existing geological and *marketing conditions* and with a view to the orderly development of the leased area on geological lines (rather than on property divisions) and *in the manner best suited to the recovery of the greatest quantity of the leased substances at the least cost*... (emphasis added by the Court of Appeal at para. 36).

It will be observed that the clause did not itself use the term marketing. That led Encana to argue that Justice McMahon had erred in finding that this amounted to the same thing (i.e. an express covenant to market) which precluded him from implying a further covenant addressing the duty to market head-on. The Court agreed with Justice McMahon. It examined related provisions in the lease and concluded that:

> [38] To the extent that any aspect of the duty to market arises by implication from clause 4, that clause expressly provides a timeline for those activities which is not immediate and has regard for the manner best suited to the recovery of the greatest quantity of leased substances at the least cost. It therefore addresses the issue of marketing and provides a "reasonable diligence" standard that reflects "existing marketing conditions" and the orderly development of the lease. If the market is not such that it would be economical to physically produce and sell the natural gas, the Respondent is not required to do so.
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> [41] In summary, the trial judge made no error in concluding that the lease contained an express marketing provision which had not been breached by the Respondent. The Respondent neither breached the provision in failing to immediately tie-in the wells located on the lease lands, nor in failing to build a pipeline to allow that tie-in before it constructed other pipelines in accordance with its plan for the orderly development of the leased lands.

It seemed to me that the trial judgement was correct and rather than repeating my conclusions from my earlier post I simply refer interested readers to those conclusions.