

“Contract Depth” Does Not Mean Optimal Depth

By: Nigel Bankes

Case Commented On: *Shallow Gas Drilling Corp v Legacy Oil and Gas*, [2015 ABQB 606](#)

It would be nice to know a little more about the facts of this case; but what appears to have happened on the basis of the rather cryptic record provided by Justice Bensler’s judgement is as follows. 1346329 Alberta Ltd (134) drilled a series of wells to earn interests in the Pierson properties. Earning was contingent on drilling the wells to contract depth which was defined as “a subsurface depth sufficient to penetrate 15 metres into the Spearfish.” The wells were drilled between late 2007 and January 2008. It was admitted that all of the wells were drilled to depths between 28.3 and 30.65 metres into the Spearfish.

Shallow Gas Drilling (SGD) (the plaintiff and appellant) agreed to participate in 134’s operations by providing a capital contribution. As a result it also earned a working interest in the properties. Legacy (the defendant and respondent) subsequently acquired 134’s interest. SGD’s participation was formalized under the terms of a Participation, Joint Operating and Clarification Agreement (the Participation Agreement). The CAPL 1990 Operating Procedure (CAPL 1990) was scheduled to that agreement.

The production results of the wells were disappointing. A report (the Sproule report) commissioned by Legacy suggested that the wells should have been completed higher within the Spearfish than they had been. As a result Legacy proposed a number of independent operations (the details of these operations are not discussed in the judgement but presumably they involved recompletion higher in the formation.) SGD declined to participate and as a result suffered a dilution of its interest (again there is no further discussion in the agreement of the operation of the penalty provisions of Article X of CAPL 1990).

SGD seems to have taken the view that Legacy breached the terms of the Participation Agreement by failing to complete in the optimal part of the Spearfish. SGD characterized this as both a breach of contract and actionable negligence. It further alleged that, given these breaches, the operation of the penalty provisions of CAPL 1990 effected an unjust enrichment which should be reversed.

On this record, Legacy sought and was granted summary judgement by Master Hanebury. Justice Bensler dismissed the appeal.

On the appeal SGD offered additional evidence in the form of an affidavit seeking to address the meaning of contract depth and what the parties might have intended by that term. Justice Bensler ruled that the proposed evidence was inadmissible:

[26] Litigants are not permitted to call evidence as to what they think the contract means: *Dow Chemical Canada Inc v Shell Chemicals Canada Ltd.*, 2010 ABCA 126 at para 16, leave to appeal to SCC refused [2010] SCCA No 234. As a corollary to this rule, parties may not call expert evidence on the meaning of a contract: *Dow* at para 17; *Lawson v Lawson*, 2005 ABCA 253, at para 52.

[27] Applying the foregoing principles to the case at bar, I conclude that the Burnett Affidavit is not relevant and material because Burnett essentially provides an interpretation of the Agreement. After reciting several clauses from the Agreement, Burnett concludes that "Clause 2 of the Agreement indicates to this author that the test wells were intended to be drilled to a depth of 15 metres into the Spearfish" (emphasis added). Burnett later writes that "Based on the Agreement, the intended drilling depth of the test wells was 15 metres into the Spearfish and not 28, 29, or 33 metres into the Spearfish" (emphasis added). In other words, Burnett opines on the intentions of the parties at the time the contract was formed, which is within the exclusive purview of the Court.

[28] The Court is not persuaded by the Appellant's submission that Burnett provides an analysis of the drilling without providing an interpretation of the Agreement itself. Burnett's opinion that "the drilling depths of [the Test Wells] were all materially deeper than the Contract Depth ... as defined in the Agreement" requires the reader to agree with Burnett that the parties intended "Contract Depth" to mean a depth of exactly 15 metres into the Spearfish and no more. In other words, Burnett cannot conclude that the drilling depths of the Test Wells exceeded the "Contract Depth" without first interpreting the meaning of that term, which he expressly does early in his report.

[29] It is also important to emphasize that the Burnett Affidavit addresses the meaning of "Contract Depth", which is the ultimate issue in this case. As held in the seminal decision *R v Mohan*, [1994] 2 SCR 9, at para 25, the criterion of relevance is applied strictly in assessing expert evidence in respect of an ultimate issue. See also *Bernum Petroleum Ltd v Birch Lake Energy Inc*, 2014 ABQB 652, at paras 53 to 54.

Justice Bensler was also of the view that Master Hanebury had been correct to reject each of the contract, tort and unjust enrichment claims. The contract claim must be rejected because the wells had in fact been drilled to the required depth (at para 50). The wells may not have been completed in the optimal part of the formation but that was not the issue. The tort claims must be rejected because at no point did the plaintiff actually allege negligence (at paras 55 – 57). And finally, the unjust enrichment claim must be rejected because the enrichment that occurred in favour of Legacy through the penalty provisions of the independent operations clause was justified by a juristic reason, namely the operation of the contract. The enrichment in favour of Legacy was therefore not an *unjust* enrichment (at paras 58 – 61).

All of which seems eminently reasonable.

The case would seem to bear a strong resemblance to the much older case of *Hi-Ridge Resources Limited v Noble Mines and Oils Ltd.*, [1978] 5 WWR 552 (BCCA).

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