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# Another Manitoba Oil and Gas Lease Termination Decision

**By:** Nigel Bankes

**Case Commented On:** *Fire Sky Energy Inc. v EverGro Energy Corporation*, 2020 MBQB 133 (CanLII)

I am not sure what's going on downstream of us these days, but we now have a third oil and gas lease termination case this year from "Friendly Manitoba." I posted on the two earlier decisions here in April.

This one is fairly straightforward. EverGro held under a CAPL 88 MAN lease form with a three-year primary term commencing January 22, 2013 and filed a caveat to protect its interest. Fire Sky top leased the property on February 9, 2017 having formed the view that EverGro's lease had expired.

## Facts

EverGro drilled a well on the leased lands during the third year of the primary term, but the well (the Hargrave well) "produced only 'trace' amounts of oil totaling approximately 130 litres" (at para 15). EverGro shut the well in in a process that "involved 'squeezing' cement into the perforations in the Well, installing a cement 'drillable plug' below grade, and a well cap at grade. In this condition the Hargrave well was not capable of producing any oil" (ibid).

In the months following (March through to September 2016), Guiliang David Fan, one of EverGro's principals, made inquiries of industry experts with a view to identifying a course of action. EverGro ultimately resolved to re-complete the well using different perforation points but it did not complete this operation until January 2017. The re-completed well then produced a "modest amount of oil" with gross revenues of $53,000 (versus expenses of $450,000)" (at para 36).

On those facts, Fire Sky Energy contended that the EverGro lease had automatically terminated in accordance with its terms.

As noted above, the lease had a three-year primary term that could be extended for so long as there were "operations" conducted on the lands with no cessation of more than 90 consecutive days. "Operations" were fairly conventionally defined to mean "any of the following":

> (i) drilling, testing, completing, reworking, recompleting, deepening, plugging back or repairing a well or equipment on or in the said lands or injecting substances by means of a well, in search for or in an endeavor to obtain,

maintain or increase production of any leased substance from the said lands, the pooled lands or the unitized lands;
(ii) the production of any leased substance;
(iii) the recovery of any injected substance; or
(iv) any acts for or incidental to any of the foregoing;
(at para 12)

**Issues**

The principal question was whether EverGro could demonstrate uninterrupted operations post-January 22, 2016 without cessation of more than 90 days. The Court concluded, not surprisingly, that EverGro could not discharge this onus. Fan's inquiries did not themselves constitute "operations"; instead, those were steps "taken in order to decide whether or not EverGro ought to conduct any further operations on the Lands" (at para 48). Furthermore, "Nor can it be said that these activities were undertaken with reasonable diligence and dispatch, given that they took Mr. Fan more than eight months" (at para 54).

EverGro also tried to rely on the Suspended Wells clause to save the lease. That clause provided that:

> If, at the expiration of the primary term or at any time or times thereafter, there is any well on the said lands, the pooled lands, or the unitized lands, capable of producing the leased substances or any of them, and all such wells are shut-in or suspended, this Lease shall, nevertheless, continue in force as though operations were being conducted on the said lands, for so long as all the said wells are shut-in or suspended and so long thereafter as operations are conducted upon the said lands, the pooled lands or the unitized lands, with no cessation, in the case of each cessation of operations, of more than 90 consecutive days. If no royalties are otherwise payable hereunder during a lease year after the primary term within which such shut-in period or periods occur and during such lease year no other operations are conducted on the said lands, the pooled lands, or the unitized lands then the Lessee shall pay to the Lessor an amount equal to ---One Hundred Fifty Seven---00/1009 Dollars ($157.00) within 90 days after the expiry of such lease year (herein called the "suspended well payment"). (at para 13)

While there was no suggestion that EverGro had ever made a suspended well payment, the argument would presumably be that the deeming effect of the first sentence of the clause was completely independent of the duty to pay in the second sentence.

The question here was whether the well that EverGro had drilled was a well that was "capable of producing the leased substances". While EverGro conceded that the well was not capable of production while suspended as described above, it contended that the well was capable of production before the cement plug was installed. Justice Theodor Bock, relying in large part on *Omers Energy Inc. v Alberta (Energy Resources Conservation Board)*, 2011 ABCA 251 (CanLII), concluded that the well did not qualify as a suspended well:

> … following the analysis in *Omers Energy Inc.*, at the expiration of the primary term the Well should at least be capable of producing oil in a meaningful quantity in its existing configuration and state of completion so that, if and when circumstances change, the Well may be put into "commercial production" by reversing the shut-in process and resuming operation. In this case, during the primary term of the Lease the Hargrave Well was only able to produce "trace" amounts of oil … (at para 69)

In conclusion, the EverGro lease had terminated in accordance with its terms and Fire Sky was entitled to a declaration to that effect as well as an order discharging EverGro's caveat.

Fire Sky also sought an accounting for all of EverGro's production post-termination and on the basis of the "harsh" rule, i.e. with no set-off for costs. This was an unusual claim. In most oil and gas lease termination cases this is a claim made by the *lessor*, not a claim made by the competing lessee. The lessor's theory is that the former lessee is either a trespasser (to real property or chattels) or engaged in the conversion of the lessor's personal property (i.e. the oil or gas once severed from the ground): see Nigel Bankes, "Termination of an Oil and Gas Lease, Covenants as to Title, and Assessment of Damages for Wrongful Severance of Natural Resources: A Comment on *Williston Wildcatters*" (2005), 68 Sask L Rev 23. A claim by the new lessee must likely be based on trespass to real property (in this case Fire Sky's exclusive profit à prendre (assuming that the lease was expressed in exclusive terms). While such a claim is in theory possible (see *Mason v Clarke,* [1955] AC 778 (HL), a "rabbiting" case!), Justice Bock preferred to dismiss the claim on the basis that Fire Sky suffered no damage "as a result of EverGro's actions" (at para 75) – but perhaps that's just another way of saying that the production was not Fire Sky's property and thus that Fire Sky could have no cause for complaint.

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