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Yes folks the language of the habendum does matter

By Nigel Bankes

Cases Considered:

Bearspaw Petroleum Ltd v Encana Corporation, 2010 ABQB 225

In this decision Justice Terry McMahon held that a petroleum and natural gas lease that provides for continuation at the end of its primary term where leased substances are "producible" will be continued where the lessee has drilled a well that has discovered natural gas in commercial quantities; the lease will be continued even though that well has not been tied in and is therefore not capable of actual production. The decision also offers a comment on implied and express covenants to market.

Facts

Bearspaw and Encana were the current parties to a petroleum and natural gas lease granted November 7, 1960 for the south east quarter for a 10 year primary term and for "so long thereafter as the leased substances or any of them are producible from the leased area, at the yearly rental of $1 per acre per annum." The lease required the lessee to commence drilling a well within six months. If production was found in commercial quantity the lessee was required to "continue with due 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 ….".

Four wells had been drilled on the leased lands or lands with which the leased lands had been pooled: well # 1, January 1962, produced for a short time; well # 2, 1962, produced oil between 1973 and 1995 and then from 2003 until abandoned in December 2005; well # 3, October 1999, on pooled lands, discovered gas in the Belly River, tested at 37 mcf per day, not tied in or produced; well # 4, December 2000, tested for gas at 56.8 mcf per day, not tied in or produced.

Encana served notice on Bearspaw that the lease had terminated in accordance with its own terms and gave Bearspaw notice to take proceedings on its caveat. Bearspaw sought a declaration that the lease was valid.

Decision

Justice McMahon held that the lease was valid and subsisting. The lease was continued at the end of the primary term if leased substances were producible. The word "producible" which had not been the subject of prior judicial interpretation has a future tense component unlike the words "produced" or "production" (at para.24). Producible does not mean that the product must be able to go to market without anything more that needs to be done (at para.25). A well that has discovered reserves in economic quantities is producible even though the actual flow of gas to market awaits regulatory approval, well-head completion or contractual arrangements with carriers (at para. 25).

The lease contained an express covenant to develop the lands and thus it was not necessary to imply a covenant (at para. 38). There was no evidence that Bearspaw was in breach of this obligation. It had drilled additional wells as the lease required and the obligation to develop was subject to a proviso with respect to marketing conditions. There was no evidence of drainage and Bearspaw was entitled to proceed cautiously once Encana had served notice of termination (at para 41).

Commentary

This is yet another case (see *Kensington Energy v B & G Energy*, 2008 ABCA 151 and my ABlawg commentary) that confirms that the language of the habendum to the lease is all important. In this case the lease was continued at the end of the primary term if the leased substances were "producible". Justice McMahon decided, reasonably enough, that "producible" means something different from actual production. Furthermore, there was no absurdity to this conclusion (*Freyberg v Fletcher Challenge Oil and Gas Inc*., 2005 ABCA 46); the lessee could not keep the lease in force by doing nothing; drilling must have identified leased substances in economic quantities (at para. 26) and the lessee had an express contractual duty to bring the leased substances to market when conditions allowed. Thus, while the lessee has the duty to show that the property is producible (i.e. that it is within the terms of the habendum), the onus is on the lessor to show that it is entitled to terminate the lease for cause for breach of the express covenant to market and develop the lands. Encana had not discharged that obligation in the present case.