Court of Queen's Bench of Alberta

Citation: Stewart Estate v TAQA North Ltd., 2013 ABQB 691

Date:
Docket: 0501 11695
Registry: Calgary

Between:

Lynda Calder in her capacity as Executrix of the Estate of Merville V. Stewart (Deceased), Lynda Calder, Morgan Stewart, Cody Stewart, Cody Stewart in her capacity as Administrator or Litigation Representative for the Estate of James D. Stewart (Deceased), and as Litigation Representative for Morgan Stewart, Jerome Development Limited, Bowen Family Properties Ltd., Ronald B. Pole, Kevin R. Pole, Danny G. Oneil in his capacity as Executor of the Estate of Mabel B. Oneil (Deceased), Robert Copley, Karen Nell Copley, Margaret Alice Demers, Mary Jean Biggar, Goldie Alberta Danielsen, Edna Keam, Wilma Marshall and Laurel Lee McLaren, 1088924 Alberta Ltd.

Plaintiffs/
Defendants by Counterclaim

- and -

TAQA North Ltd., Nexen Inc., ExxonMobil Canada Ltd., Esprit Exploration Ltd., Bonavista Energy Corporation, Triquest Energy Corp. and Coastal Resources Limited

Defendants/
Plaintiffs by Counterclaim

Reasons for Judgment
of the
Honourable Madam Justice B.E. Romaine

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I. INTRODUCTION

[1] This action involves five freehold petroleum and natural gas leases covering most of a section of land near Crossfield, Alberta. The Plaintiffs are some of the current land owners and a top-lessee, whose top-lease would become effective only if it is determined that the existing leases have terminated. The Defendants are oil and gas companies who are the current lessees. The main issue in dispute is whether the leases have terminated in accordance with their terms as a result of the cessation in operations and production from a well on the land between 1995 and 2001. Specifically, the issue is whether the Defendants (or their predecessors) were required to operate the well at a loss or nominal return in order to preserve and continue the leases. This requires an interpretation of certain terms of the five leases. At trial, a number of factual and expert witnesses provided evidence about the decision made to shut-in the well for economic reasons.

[2] In addition to the main issue, the parties raise four preliminary issues:

a) whether the registered land owners to which two of the leases apply are the proper parties to seek a declaration that those leases have terminated;
b) whether the top-lessee Plaintiff has standing before the Court;
c) whether a number of the claims are barred in whole or in part by reason of the *Limitations Act*, RSA 2000, c L-12; and

d) whether several of the claims are barred in whole or in part by the doctrines of estoppel, laches or acquiescence.

[3] With respect to the preliminary issues, I conclude:

a) the registered land owners to which two of the leases apply have not satisfied me that they are the proper parties to seek a declaration that those leases have terminated, as there are other interested parties who were not before the Court;
b) the top-lessee Plaintiff has standing before the Court on the issue of lease validity, but has no claim for damages;
c) the Plaintiffs' claims for unjust enrichment, trespass and conversion are barred pursuant to the *Limitations Act*; and
d) none of the claims are barred in whole or in part by the doctrines of estoppel, laches or acquiescence.

[4] With respect to the main issue involving contractual interpretation of the leases, the action is dismissed. The well was shut-in for reasons permitted under the leases, and the leases did not terminate as a result of the cessation in operations and production. In the event I am in error in dismissing the action, I also address the issue of damages. I would have awarded damages in restitution based on a royalty, or royalty plus bonus, approach, and not on the basis of disgorgement of profits.

II. OVERVIEW

A. The Parties

[5] The Plaintiffs, other than 1088924 Alberta Ltd. ("108") and Timothy Bowes, are members of five families and two family holding companies. Through inheritance, they are the current registered freehold owners of most of the lands and petroleum and natural gas rights in Section 25, Township 27, Range 1, West of the 5th Meridian ("Section 25" or the "Section 25 Lands") near Crossfield, Alberta, other than a small sliver of land (12 acres) originally owned by the Canadian Pacific Railway as a railway right-of-way. Their parents or grandparents entered into leases of these rights in the 1960s with predecessors in interest of the Defendant resource companies. One of the issues in this litigation is whether two of these leases were assigned by the original lessor to parties not named as plaintiffs, and, therefore, whether all of the necessary parties have been joined in this litigation.

[6] The Plaintiff 108 is a company formed by Freehold Solutions Inc. ("FSI"), a top-lessee with respect to the five leases. It was FSI's intention that 108 would take over the leases and operate an existing well drilled on Section 25 if the current leases are declared to be invalid. FSI assigned its agreements to 108. 108 was added to the litigation as a Plaintiff in 2009 and has registered caveats against the Section 25 Lands. FSI and the Plaintiff Danny Oneil have been the main organizers and promoters of this litigation. The Plaintiff Timothy Bowes is President of

FSI and 108. The relationship of FSI and the other Plaintiffs and how such a relationship came to develop is discussed in detail later in these Reasons for Judgment.

[7] The predecessors in interest of the Defendants Nexen Inc., ExxonMobil Canada Ltd., Coastal Resources Limited and Bonavista Energy Corporation entered into the leases with the predecessor freeholder owners of the Section 25 Lands, and these corporations are the current interest holders and lessees under the leases. The relationship of TAQA North Ltd., Esprit Exploration Ltd. and Triquest Energy Corp. to the leases will be described later. Caveats in respect of all of the leases were filed by the Defendant lessees.

B. Overview of Leases and Operations

[8] In September, 1968, the then-lessees pooled their interests under a Pooling Agreement, as they had the right to do. Under the Pooling Agreement, the lessees combined their interests in each of the leases such that any production or deemed production of leased substances from Section 25 constituted a continuation of all of the leases. The then-lessors under all five leases became entitled to royalties in respect of their pro-rata shares of leased substances produced and marketed from any well drilled on the Section 25 Lands.

[9] The current percentage working interests in production under the Pooling Agreement are as follows:

Nexen -	12.03%
ExxonMobil -	12.03%
Coastal -	15.89%
Bonavista -	60.05%

[10] There are five leases in issue in respect of the Section 25 Lands. The leases differ from one another slightly, but the provisions that are key to the issues in this litigation are substantially the same. The leases provide for a ten-year primary term, continuing so long thereafter as there is production from the lands. After the primary term, if production has ceased and the lessee commences further drilling or working operations within 90 days, the lease remains in force so long as operations continue and if they result in production. These leases contain a so-called "Third Proviso", to the effect that "if . . . any well . . . is shut-in, capped, suspended or otherwise not produced as the result of a lack of or an intermittent market, or any cause whatsoever beyond the Lessee's reasonable control, the time of such interruption or suspension or non-production shall not be counted against the Lessee . . .", or a slight variation on this wording.

C. The 7-25 Well

[11] On September 17, 1968, a well was drilled at 7-25-27-1W5M on the Section 25 Lands (the "7-25 Well"). This well and its history is the focus of the litigation. The well was shut-in, wherein production was suspended, from August 1, 1995 through to January 13, 2001,

approximately five-and-a-half years. The Plaintiffs submit that it was shut-in because it no longer met the operator's internal profitability hurdles and not as a result of a lack of or an intermittent market, and that thus the Defendants cannot rely on the Third Proviso to continue the term of the leases. The Defendants submit that the 7-25 Well was shut-in because it was uneconomical, that this was a prudent decision by the lessees, and that the leases never terminated.

[12] The 7-25 Well was drilled by Jefferson Lake Petrochemicals of Canada Ltd., one of the original lessees, in September 1968, within the 10 year primary term of the SE/4 Section 25 lease. It was drill stem tested in the Basel Quartz ("BQ") geological formation on October 30, 1968, and perforated on August 20, 1970.

[13] Two potentially producing formations were discovered: the BQ and the Crossfield (sometimes referred to as "Wabamun") formations. The Crossfield formation is a deeper formation than the BQ formation, and produces sour gas. The initial target formation for the well had been the Crossfield formation, but for various reasons relating to transportation and processing, Jefferson Lake decided to produce gas initially from the BQ formation.

[14] Production from the 7-25 Well in the BQ formation commenced in March 1971 and continued, subject to certain cessations in production, until June 1980 when the well was shut-in. Production from the BQ formation was subsequently suspended in September 1980 and the perforations into that formation were cemented. From 1978 to 2004, Nexen (or its predecessor in interest, Canadian Occidental Petroleum Ltd.) was the designated operator of the 7-25 Well under the Pooling Agreement and the operations agreement amongst the working interest owners under the original leases, except for a brief period in 2011, as later described.

[15] The 7-25 Well was completed in the Crossfield formation on May 16, 1978. Production commenced in March 1981 and continued, subject to certain cessations in production, until July 1995.

[16] In July 1995, the 7-25 Well was suspended in the Crossfield formation and gas was not produced from the well from the end of July 1995 through January 2001. This period is of primary significance in the litigation, although the Plaintiffs have put in issue for limited purposes the Defendants' decisions and actions with respect to the leases during previous periods of time. However, the Plaintiffs do not allege that prior periods of cessation in production led to a termination of the leases.

[17] During the period from August 1995 through January 2001, shut-in royalty payments (also referred to as annual rentals or delay rentals under the leases) were paid by the then-lessees to the then-lessors. It is important to note that shut-in royalty payments were paid during this time period by Coastal and Bonavista (or its predecessor in interest) to Wheatland Farming Co. Ltd. with respect to two of the leases. These shut-in royalty payments were received by all of the payees. Although there was some evidence of late payments, the Plaintiffs do not raise this as an issue with respect to the continued validity of the leases in this litigation, except in a limited sense that will be described later.

[18] In November 2000, Triquest, a working interest holder at the time, examined the possibility of bringing the 7-25 Well back into production and circulated an Independent Operations Notice to other working interest holders with respect to its intention to re-enter and recomplete the 7-25 Well in the BQ formation to begin producing gas from that formation.

[19] As part of the recompletion, Triquest perforated the BQ formation in the 7-25 Well on January 19, 2001, and fracture-stimulated the well on January 21, 2001. The 7-25 Well was put back on production in the BQ formation in February 2001.

[20] Triquest became the operator of the 7-25 Well during well recompletion, but Nexen resumed that role when the independent operation was complete. Bonavista assumed the role of designated operator on September 1, 2004 and has operated the 7-25 Well since that date.

[21] On or about January 13, 2011, the 7-25 Well was shut-in by court order pursuant to an interim injunction issued in separate litigation in this Court, at the behest of the owner of an adjoining gas storage facility, CrossAlta Gas Storage & Services Ltd. No production or operations to obtain production have occurred on the Section 25 Lands since January 13, 2011. In that separate litigation, CrossAlta alleges that the working interest owner defendants were producing CrossAlta's storage gas from the 7-25 Well, which is adjacent to CrossAlta's gas storage reservoir.

D. Chain of Title for Original Leases and Pooling Agreement

[22] All original leases reserved a 12.5% royalty to the lessor in respect of the substances produced and marketed from the leased lands.

[23] The five leases in issue in this action in respect of the Section 25 Lands, discussed below, are as follows:

a. Jefferson SW/4 Lease;
b. Union NE/4 Lease;
c. Scurry NE/4 Lease;
d. Scurry SE/4 Lease; and,
e. Imperial NW/4 Lease.

[24] A table setting out the current registered mineral owners and current lessees of the Section 25 Lands is attached as **Appendix A** to this decision. The table does not reference the issue of whether the Stewart family members are in fact the current lessors with respect to the Scurry NE/4 Lease and the Scurry SE/4 Lease, which issue is described in detail later in this decision. A diagram of the Section 25 Lands, indicating the location of the various leases, is attached as **Appendix B** to this decision. Selected lease provisions are included in **Appendix C** to this decision.

a. Jefferson SW/4 Lease

[25] On January 8, 1968, Jefferson Lake entered into a lease with Nellie B. Pole, the grandmother of the Plaintiff Danny G. Oneil, covering the SW/4 of Section 25 (the "Jefferson SW/4 Lease"). The Plaintiffs Bowen Family Properties Ltd., Ronald B. Pole and Kevin R. Pole as joint tenants, and Mr. Oneil as executor of the estate of his mother, Mabel B. Oneil, are the current registered owners of Ms. Pole's interest in the mines and minerals, other than coal, in the SW/4 of Section 25, each holding a one-third interest.

[26] The successor in interest to Jefferson Lake by an amalgamation effective July 12, 1971 was Canadian Occidental Petroleum Ltd., which in turn became Nexen Canada Ltd. and, ultimately, Nexen. Currently, Nexen and ExxonMobil are each 50% working interest owners under the Jefferson SW/4 Lease.

[27] The Pooling Agreement includes the lands under the Jefferson SW/4 Lease. Nexen is the successor in interest to Jefferson Lake as a named party to the Pooling Agreement, and ExxonMobil is the successor in interest to Mobil Oil Canada Ltd. as a named party to the Pooling Agreement.

[28] The relevant wording of the Third Proviso of the Jefferson SW/4 Lease is as follows:

> . . . provided that if . . . any well on the said lands or the pooled lands . . . is shut-in, capped, suspended or otherwise not produced as the result of a lack of or an intermittent market, or any cause whatsoever beyond the Lessee's reasonable control, the time of such interruption or suspension or non-production shall not be counted against the Lessee, anything hereinbefore contained or implied to the contrary notwithstanding.

b. Union NE/4 Lease

[29] Jean Ella Irwin, as lessor, and the Union Oil Company of California, as lessee, entered into the original gas lease on May 9, 1961 for a portion of the NE/4 of Section 25 (the "Union NE/4 Lease"). Edna Keam, Wilma Marshall and Laurel Lee McLaren as executrix for Betty Blanche Cardiff are the current registered owners of Ms. Irwin's interest in the mines and minerals, other than coal, in the NE/4 of Section 25, each as to a one-third interest.

[30] Coastal is the successor in interest to Union under the Union NE/4 Lease, having acquired its interest from Unocal Canada Limited effective April 1, 1993.

[31] Coastal is also the successor in interest to Union as a named party to the Pooling Agreement, having acquired its interest under the Pooling Agreement from Unocal Canada effective April 1, 1993. The Pooling Agreement includes the lands under the Union NE/4 Lease.

[32] The relevant wording of the Third Proviso of the Union NE/4 Lease is as follows:

> . . . PROVIDED THAT if drilling, working or production operations are interrupted or suspended as the result of any cause whatsoever beyond the Lessee's reasonable control including, in the case of production operations, lack of or an intermittent market, the time

of such interruption or suspension shall not be counted against the Lessee, anything hereinbefore contained or implied to the contrary notwithstanding.

c. *Scurry NE/4 Lease*

[33] Merville V. Stewart, as lessor, and Scurry Rainbow Oil Limited, as lessee, entered into the original lease on November 30, 1967 for the remainder of the NE/4 of Section 25 (the "Scurry NE/4 Lease"). The registered owners of Mr. Stewart's interests in the mines and minerals, other than coal, until December 2012, just before the trial commenced, were:

(a) Jerome Development Limited, as to a one-half interest;

(b) as to the other one-half interest:

(i) Lynda Calder as to a 2/12 interest;
(ii) James D. Stewart as 2/12 interest;
(iii) Cody Stewart as to a 1/12 interest; and
(iv) Morgan Stewart as to a 1/12 interest.

Pursuant to certain transactions described later in paragraphs 86 and 87 of this decision, Jerome Development is the current registered owner of Merville Stewart's interests in the Scurry NE/4 Lease in their entirety.

[34] Scurry Rainbow held 50% of its interest under the Scurry NE/4 Lease in trust for Union. As such, Union held a 50% interest as original lessee under the Scurry NE/4 Lease.

[35] The successor in interest to Scurry Rainbow by amalgamation was Home Oil Company Limited, which in turn assigned its 50% interest in the Scurry NE/4 Lease to Amoco Canada Resources Ltd. as of March 23, 1994. Thereafter:

(a) on October 16, 1996, Amoco assigned its 50% interest in the lease to TAQA North; however, Canadian 88 exercised a right of first refusal in respect of the natural gas in the BQ, Wabamun and Elkton formations under this lease and entered into a sale agreement with Amoco dated January 16, 1997 with respect to Amoco's interest in the natural gas in those formations;

(b) following the two Amoco transactions, TAQA North had acquired all of Amoco's 50% legal interest in the lease; however TAQA North held Canadian 88's beneficial interest in the natural gas in the BQ, Wabamun and Elkton formations in trust for Canadian 88;

(c) on June 1, 2000, Canadian 88 sold its beneficial interest in natural gas in the BQ, Wabamun and Elkton formations under the lease to Triquest and, following that transaction, TAQA North assigned legal title to its interest in the lease to Triquest by way of a freehold lease assignment dated November 16, 2000; however, Triquest held TAQA North's beneficial interest in trust for TAQA North pursuant to a declaration of trust dated November 30, 2000;

(d) following these transactions, Triquest had acquired all of TAQA North's 50% legal interest in the lease and was the legal and beneficial owner of the interest in the natural gas in the BQ, Wabamun and Elkton formations; however, Triquest held TAQA North's beneficial interest in the lease in trust for TAQA North; and

(e) by virtue of an agreement made as of January 29, 2004, Triquest's legal and beneficial interests in the lease were transferred to Bonavista.

[36] Coastal is also the successor to Union's 50% working interest under the Scurry NE/4 Lease, having acquired its interest from Unocal Canada effective April 1, 1993. Coastal is the successor in interest to Union as a named party to the Pooling Agreement under the same agreement. The Pooling Agreement includes the lands under the Scurry NE/4 Lease.

[37] Bonavista is the successor in interest to Scurry-Rainbow, Imperial Oil Limited and Canadian Pacific Oil and Gas Limited as named parties to the Pooling Agreement.

[38] Bonavista and Coastal are currently the working interest owners, each as to a 50% interest in the natural gas in the BQ, Wabamun and Elkton formations under the Scurry NE/4 Lease, while Coastal and TAQA North are each currently the working interest owners as to a 50% interest in all petroleum and natural gas (excluding natural gas in BQ, Wabamun and Elkton formations) under the Scurry NE/4 Lease.

[39] The relevant wording of the Third Proviso of the Scurry NE/4 Lease is nearly identical to that of the Jefferson SW/4 Lease.

d. Scurry SE/4 Lease

[40] Merville Stewart, as lessor, and Scurry Rainbow, as lessee, entered into the original lease for the SE/4 of Section 25 (the "Scurry SE/4 Lease") on January 7, 1964. The current registered owner of Mr. Stewart's interest in the mines and minerals, other than coal, in the SE/4 of Section 25, is Jerome Development.

[41] The successor in interest by amalgamation to Scurry Rainbow was Home Oil, which in turn assigned its interest in the Scurry SE/4 Lease to Amoco as of March 23, 1994. Thereafter, by transactions that mirrored the transactions described with respect to the Scurry NE/4 Lease, Bonavista became the current working interest owner as to a 100% interest in the natural gas in the BQ, Wabamun and Elkton formations under the Scurry SE/4 Lease, while TAQA North became the current working interest owner as to a 100% interest in the natural gas (excluding natural gas in the BQ, Wabamun and Elkton formations) under the Scurry SE/4 Lease.

[42] Bonavista is also the successor in interest to Scurry Rainbow, Imperial and Canadian Pacific as named parties to the Pooling Agreement. The Pooling Agreement includes the lands under the Scurry SE/4 Lease.

[43] The relevant wording of the Third Proviso of the Scurry SE/4 Lease is nearly identical to that of the Jefferson SW/4 Lease.

e. Imperial NW/4 Lease

[44] William Murdoch Copley, as lessor, and Imperial Oil Limited, as lessee, entered into the original lease for the NW/4 of Section 25 (the "Imperial NE/4 Lease") on December 13, 1961. Robert Copley, Karen Nell Copley, Margaret Alice Demers, Mary Jean Biggar and Goldie Alberta Danielsen are the current registered owners of Mr. Copley's interest in the mines and minerals, other than coal, in the NW/4 of Section 25.

[45] Imperial assigned its interest in the Imperial NW/4 Lease and transferred its interest in the related caveat to Canadian 88, which subsequently became the Defendant Esprit and, ultimately, Pengrowth. Bonavista is the current working interest owner under the Scurry NW/4 Lease.

[46] The relevant wording of the Third Proviso of the Imperial NW/4 Lease is nearly identical to that of the Jefferson SW/4 Lease.

E. Origins of the Current Dispute

[47] In 2001, Mr. Oneil's elderly mother, who was then a registered interest holder under the Jefferson SW/4 Lease, gave Mr. Oneil power of attorney over her affairs. Prior to this, Mr. Oneil knew very little about the production or non-production of the 7-25 Well, other than a general family knowledge that the lease existed.

[48] In March 2003, while reviewing his mother's affairs, Mr. Oneil noticed that Nexen had not issued a royalty cheque for the month of March 2002. Upon further examination, Mr. Oneil noticed that Nexen had been deducting the Alberta Freehold Mineral Tax and that ExxonMobil had not appeared to pay any royalties for October, November and December 2002.

[49] Mr. Oneil contacted both Nexen and ExxonMobil by email to address his concerns about royalty payments. Nexen informed Mr. Oneil that a cheque for March 2002 had been issued but not cashed, and agreed to stop payment on the first cheque and issue a new one. Nexen also clarified Mr. Oneil's concerns regarding the deductions of the Alberta Freehold Mineral Tax. ExxonMobil agreed to mail a royalty cheque for the months of October 2002 through February 2003.

[50] When he received the royalty cheque from ExxonMobil for $3,849.03, Mr. Oneil noticed that the amount was for much less than the royalty cheque from Nexen for the same period, which was approximately $14,000. Given that the companies held the same percentage interest

in the lands, Mr. Oneil became concerned that ExxonMobil was underpaying its royalties and contacted the company requesting clarification.

[51] After several months of discussions with ExxonMobil in early 2003, Mr. Oneil received an email from Nexen notifying him that Nexen had overpaid royalties in the amount of $72,000. In discussions with Nexen, Mr. Oneil indicated that his mother was willing to repay any amount that had been overpaid, but requested assistance in dealing with the tax implications of this error and the adverse effect on his mother's senior subsidy benefits.

[52] In July 2003, ExxonMobil notified Mr. Oneil that it also had overpaid royalties and that it would be withholding future royalty payments until such time as it recovered the overpayment. Mr. Oneil also requested assistance from ExxonMobil in dealing with the tax and benefits implications of this error for his mother. Mr. Oneil testified that ExxonMobil demanded several times that Mr. Oneil make an offer of payment terms. Mr. Oneil became concerned that ExxonMobil was preparing to sue for the overpayment of royalties.

[53] In August 2003, Mr. Oneil notified the other holders of leasehold interests in the Jefferson SW/4 Lease about his concerns. He decided to seek legal advice. Subsequently, counsel for Mr. Oneil and the other leasehold interest holders contacted ExxonMobil and Nexen in late 2003, indicating that his clients had concerns about the validity of the leases. In separate discussions, both ExxonMobil and Nexen gave their opinions that the leases continued to be valid.

[54] Mr. Oneil's counsel also told him of the existence of FSI, indicating that it may be interested in helping him. FSI is a small oil and gas company that holds a number of different assets and leases. It is also in the business of acting on behalf of lessors who have limited experience in the oil and gas sector in disputes with corporate lessees.

[55] FSI is owned by three parties. Tim Bowes, President of FSI, holds a one-third interest in the company with his wife through a holding company. Darryl Erickson and his wife own another one-third interest. Robyn Lore, through a holding company Willmist Holdings Ltd., owns the final one-third interest. Mr. Bowes, Mr. Erickson and Mr. Lore are all directors of FSI, and all three have experience in the financial and management side of the oil and gas business, including experience as landmen.

[56] Mr. Oneil instructed his counsel to contact FSI, and, in July 2004, Mr. Oneil and Ms. Baxter-Gilmour (on behalf of Bowen Family Properties) had their first meeting with Mr. Bowes. While Mr. Bowes agreed that there were problems with the Jefferson SW/4 Lease, Mr. Bowes advised Mr. Oneil that FSI was not prepared to do a historical title opinion unless the remaining parties with interests in the Section 25 Lands agreed to join in litigation against the lessees.

[57] At the July 2004 meeting, Mr. Bowes also explained how FSI would be prepared to undertake a "top lease" should the existing leases be found invalid. A top lease is a lease that only comes into effect if it is determined that the existing lease has terminated. The top lease would provide that FSI would pay royalties to the lessors at a rate of 18% and that FSI would

agree to pay any legal costs arising from any action that had to be taken. As part of the deal, FSI would split 50% of any damages recovered in legal proceedings with the Plaintiff lessors. Later in November 2004, FSI agreed to increase the royalty rate under the top leases from 18% to 20%.

[58] Mr. Oneil has known some of the other Plaintiffs for most of his life. Bowen Family Properties is a family company owned by his cousins. Ron Pole is his uncle and Kevin Pole is his cousin. Mr. Oneil has also known Lynda Calder from the time Ms. Calder was a high school student. He was aware Jerome Development was owned by the Stewart family. While Mr. Oneil testified to being aware of who Karen Copley was, he did not know her very well. Prior to the litigation, Mr. Oneil did not personally know any of the other Plaintiffs.

[59] Mr. Oneil (on behalf of his mother), Ms. Baxter-Gilmour (on behalf of Bowen Family Properties) and Ronald Pole signed an agreement with FSI on November 1, 2004. These three Plaintiffs, together with Kevin Pole, are referred to as the "Bowen Group". This agreement provides that FSI would advise the Bowen Group within 120 days whether it would analyze the Jefferson SW/4 Lease, including a "historical and legal" analysis of production to determine if further money was owed and whether the lease had terminated. In either case, FSI would "take action as exclusive agent" of the lessors at its own cost and expense to obtain the money owed or obtain a determination that the lease had terminated. FSI would provide a law firm to handle the matter and pay all that law firm's fees and disbursements. In consideration, the lessors would pay FSI 50% of anything received from any settlement or judgment in the action.

[60] The FSI agreement attaches a top lease which would become effective automatically if it is determined that the existing lease has terminated. Executed copies of the top lease were to be held by a law firm until the lessors and FSI directed their release, but it is not clear if such top lease was actually executed.

[61] According to the agreement, if the lessors do not wish to accept a settlement recommended by FSI, they have the right to proceed without FSI, although FSI would be entitled to 25% of anything ultimately received, net of lawyers' fees. The lessors agree to co-operate with FSI in its negotiations with the other owners of Section 25 natural gas rights.

[62] Kevin Pole did not sign the agreement on November 1, 2004, but by signatures dated between June 6 and September 11, 2008, he and the other two representatives of the Bowen Group executed a supplemental agreement with FSI, said to be effective November 1, 2004. The agreement provides a replacement top lease, also back-dated to November 1, 2004, which this time was executed by all members of the Bowen Group. The agreement provides that by entering into the top lease, "the Lessors made an absolute disposition of their reversionary interest in the said lands such that the entire right, title, estate and interest of the Lessee [Jefferson Lake] in the lands vested in FSI pursuant to the terms of the Top Lease immediately as of the effective date thereof." However, it also provides that "FSI's right to possession under the Top Lease is contingent upon and deferred until there is a determination that the [Jefferson SW/4 Lease] has terminated."

[63] The supplemental agreement makes it clear that FSI is not required to make any payments, other than an unspecified "bonus consideration", unless and until the Jefferson Lake SW/4 Lease has terminated, FSI is in possession of the lands and is producing petroleum substances.

F. Lynda Calder and the Jerome Group

a. Agreements with FSI

[64] Mr. Oneil called the Plaintiff Lynda Calder in 2005. Merville Stewart, Ms. Calder's father, died in 1984 and Ms. Calder is the executor of his estate. Mr. Oneil thought that Ms. Calder's family owned most of the east half of Section 25.

[65] Mr. Oneil described to Ms. Calder the arrangement he had entered into with FSI, and told her of FSI's opinion that the lease had terminated. He asked her if the family still had interests in Alberta, and said that he knew that a portion of Section 25 was registered in the name of Jerome Development. Although Ms. Calder stubbornly insisted that Jerome Development no longer held any assets in Alberta, Mr. Oneil told her that Mr. Erickson would be in touch on behalf of FSI to explain things further.

[66] Mr. Erickson contacted Ms. Calder and explained FSI's proposal. He then sent her some documentation, including a draft of an agreement with FSI and land titles certificates dated November 10, 2004, indicating that the mines and minerals under a portion of the NE/4 and the SE/4 of Section 25 were registered in the name of Jerome Development as to 50% of the NE/4 and 100% of the SE/4. She discussed this with her family and could see no downside risk to proceeding, as FSI would agree to fund the litigation. FSI invited her and her brother, James Stewart (now deceased), to Calgary, where they met with the three FSI principals.

[67] Ms. Calder and Mr. Stewart decided to sign the proposed agreement with FSI. Ms. Calder signed the agreement on March 12, 2005, both in her personal capacity and as executor and beneficiary of her father's estate. She also signed the undated top lease attached to the proposed agreement, although her signature was not witnessed. This top lease mis-states the legal description of the leased lands in part, referring to the SW/4, rather than the SE/4 of Section 25.

[68] James Stewart signed the agreement in his own capacity and as beneficiary of the estate of Merville Stewart. It is not clear from the document when he signed it. It does not appear that he signed the attached top lease. James Stewart's daughter, Cody Stewart, was also added and signed the agreement in May 2005. She testified that her father had advised her of the FSI deal, telling her that it appeared that her grandfather had an interest in land in Alberta that the family did not know about.

[69] The agreement is substantially similar to that signed by the Bowen Group, except that the top lease is stated to be dated "within 30 days of the removal of encumbrances from the title", rather than becoming automatically effective if it is determined that the original lease has terminated. No fully executed copy of the top lease has been discovered or put into evidence.

The agreement also compels the lessors to transfer the petroleum and natural gas rights in the portion of the NE/4 and the SE/4 of Section 25 (which the agreement reflects were then registered in the name of Merville Stewart as to 50% of the NE/4, and Jerome Development as to 50% of the NE/4 and 100% of the SE/4) to the beneficiaries of the estate and the shareholders of Jerome Development, which, the agreement notes, may involve reviving Jerome Development as a corporation under the Alberta *Business Corporations Act*, RSA 2000, c B-9.

[70] Jerome Development was a family holding company incorporated by Merville Stewart in 1969. It was struck from the Alberta Corporate Registry in 1985, having failed to file annual returns for the last two years. Ms. Calder revived the corporation for the purpose of this litigation on August 8, 2005.

[71] Morgan Stewart, James Stewart's son, was also a beneficiary of the estate of his grandfather, but he was estranged from the family at this time and no one knew where he was. He was not included among the signatories to the agreement.

[72] In 2008, some of the members of the Stewart family (the "Jerome Group") executed supplemental agreements with FSI that are substantially the same as the supplemental agreement executed by the Bowen Group. Ms. Calder executed separate agreements for the NE/4 and the SE/4 on August 7, 2008, both in her own capacity and on behalf of Jerome Development, and also executed the top leases that were attached, which were post-dated to March 16, 2005.

[73] James Stewart executed a supplemental agreement and a new top lease on September 9, 2008. Mr. Stewart also signed a supplemental agreement and lease on the same date on behalf of his son, Morgan Stewart, although Mr. Stewart had no legal authority to do so. It appears that Morgan Stewart died in early 2011. Cody Stewart executed a supplemental agreement and a new top lease on September 15, 2008.

[74] The involvement of the Jerome Group in this litigation gives rise to the issue of whether its members the Plaintiffs Lynda Calder, Morgan Stewart, Cody Stewart and Jerome Development Limited, have standing as lessors, given certain complications with respect to Merville Stewart's entitlement to the mines and minerals in the east half of Section 25 after 1977. These complications are described in the following section of these Reasons for Judgment.

b. Assignment of Interest to Snell Farms Ltd.

[75] In October 1995, Ms. Calder received a letter from Erica Heuer at Montreal Trust Company inquiring about the status of Jerome Development for royalty payment purposes, pursuant to a royalty trust. Ms. Calder spoke with Ms. Heuer, expressing her surprise at the inquiry, as she understood that her family had no assets left in Alberta. In August 1996, Ms. Calder and Ms. Heuer had another conversation. Ms. Heuer told Ms. Calder that Montreal Trust had made a mistake and that the royalty was payable to Snell Farms Ltd. and another company, Fairholm Development, which was associated with Robert Kolstad, a friend of Merville Stewart. Ms. Calder's handwritten notes on these letters indicate that she understood at the time that royalty trust certificates in relation to Section 25 were owned by Snell Farms and Mr. Kolstad.

Ms. Calder asked her brother, James Stewart, about this, and his comment was that this was one of "Mr. G.'s" companies.

[76] Mr. G. was Merville Stewart's lawyer and also the lawyer for Jerome Development until it was struck off the Alberta Corporate Registry in 1985. Ms. Calder testified that her father had a poor view of Mr. G.'s ethics, but that he had continued to retain Mr. G. because, he told her, it was just too hard to switch lawyers.

[77] At pre-trial questioning, Ms. Calder was presented with assignment agreements dated March 1, 1977 that she conceded appeared to be signed by her father, transferring his mineral rights in the SE/4 and NE/4 of Section 25 to Snell Farms. While she tried to resile from that testimony at trial, her explanation for her change of opinion was not satisfactory or credible.

[78] Ms. Calder testified that she "had a problem" with these assignment agreements, as her father's "mantra" to his children was that they should never sell mineral rights. She also found it suspicious that the assignments were signed on behalf of Snell Farms by Mr. G., with Mr. G.'s wife as witness to Ms. Calder's father's signature. She testified that her brother, James Stewart, agreed that there was something "not cricket" with the documents.

[79] Merville Stewart left Alberta in the early 1970s, as he began to suffer serious health concerns and could no longer run a cattle operation. Ms. Calder was aware that her father sold the "home place" in the mid 1970s, although she was not living in Canada at that time and so could not provide a precise date. Ms. Calder's mother stayed in Alberta, living in the family home in Airdrie. Merville Stewart visited her from time to time until she died in 1983. Ms. Calder admitted that she had infrequent contact with her father during those years, and that he had never discussed his business affairs with her. While James Stewart worked for a time with his father in his father's auction business, they had been estranged for a number of years.

[80] When Ms. Calder took over as executor of Merville Stewart's estate, she found nothing about any interests in Section 25 among his papers, although she found some documents relating to gross royalty trusts in other lands.

[81] Ms. Calder kept the estate open until 2005, as the estate had liabilities and she wished to pay her father's creditors. To that end, she made inquiries about possible assets. Ms. Calder testified that she had asked her brother, James Stewart, many times about the possibility that the family still had an interest in Section 25 and his answer was always the same: James Stewart believed that the estate owned absolutely nothing in Alberta.

[82] Ms. Calder was also in touch from time to time with Mr. Kolstad, a family friend who was in the oil and gas business and was knowledgeable about Merville Stewart's business interests. She testified that she took one of the existing gross overriding royalty trust certificates relating to other lands to Mr. Kolstad during a visit and asked him if there was anything left for the estate on Section 25. He said that there was not. Ms. Calder agreed that Mr. Kolstad was knowledgeable about her father's business and that, in fact, he had witnessed the Scurry SE/4 Lease when her father signed it.

[83] Ms. Calder was also aware that Jerome Development had been struck from the Alberta Corporate Registry even before her father died, and she testified that she did not revive it as executor prior to this litigation, as her understanding was that there were no assets left in the name of that company.

[84] Ms. Calder has never investigated the Snell Farms assignments, and Snell Farms is not a party to this litigation. Neither is Fairholm Development.

[85] From the documentation presented in evidence, it appears that when the Scurry NE/4 Lease and the Scurry SE/4 Lease were entered into, Merville Stewart was the freehold owner of the SE/4 of Section 25 and that portion of the NE/4 of the Section 25 that lies to the south of the lands covered by the Union NE/4 Lease, which collectively comprise nearly half of Section 25.

[86] From the documentation, it also appears that in March 1972, Mr. Stewart transferred 50% of his interest in the NE/4 of Section 25 to his family holding company, Jerome Development, and kept the other 50% interest in mines and minerals in his name. He also transferred all of his freehold interest in the SE/4 of Section 25 to Jerome Development. The transfer documents were witnessed by Mr. G. The transfer is dated in 1972 but appears to have been filed at the Land Titles office in 1974. Certificates of title dated May 1974 indicate that Jerome Development is the owner of the lands and all mines and minerals, other than coal, in the SE/4 and an undivided half interest in the NE/4 of Section 25.

[87] It thus appears that Jerome Development has been the registered freehold owner of the SE/4 and 50% of the NE/4 of Section 25 from 1972 to the present. From 1974 to 2008, Mr. Stewart continued to be the registered freehold owner of the other 50% interest in mineral rights in the NE/4 of Section 25. Although he died in 1984, this interest was only transferred to the beneficiaries of his estate in 2008. By agreement dated December 8, 2011 (about a month before trial) and a transfer of land registered on January 5, 2012, this 50% interest was transferred to Jerome Development.

[88] There is no direct evidence that the two Scurry Leases were assigned to Jerome Development in 1974 or any other time, other than what the Plaintiffs submit may be implied from the wording of the 1972 transfer documentation. Nor is there any evidence that Mr. Stewart or his solicitor, Mr. G., or Jerome Development advised the lessees under the Scurry Leases of the transfers of freehold interest to Jerome Development.

[89] I am satisfied that Ms. Calder recognized the signature on the assignments as being that of her father, and only resiled from her previous testimony at trial when she understood the adverse implications of this evidence. Mr. Stewart's signature is witnessed by A.G., Mr. G.'s wife, and the assignments include a commissioned affidavit of execution. Snell Farms executed the assignments by its agent, Mr. G.

[90] The assignments are prepared in part on pre-printed forms and are entitled "Assignment of Natural Gas Lease". They commence with the words "This Indenture" and are dated March 1,

1977. The recitals reference the Scurry NE /4 Lease and the Scurry SE/4 Lease, the dates of the leases and the mineral interests covered by the leases. The recitals also state that Mr. Stewart has agreed to assign the leases for one dollar and other valuable consideration. The assignments contain the following reference, added to the printed form:

> The within Assignment is in addition to and forms a part of an Agreement for Sale dated the 1st of March, A.D. 1977, whereby MERVILLE V. STEWART did sell, assign and transfer unto the Transferee herein certain assets and it is agreed and understood that the within Assignment is subject to the same terms and is a part of the said Agreement of 1 March, 1977.

[91] As part of the printed form, Mr. Stewart as assignor covenants that the leases are good, valid and subsisting leases, that the rents have been paid for the current year and that the assignor has the right, power and authority to assign the leases. The assignments specify that they will be binding on the heirs, executors and administrators of the assignor and assignee.

[92] The assignments were sent to the appropriate lessees by Mr. G., and it appears that from 1977 to 1982, royalties under the leases were paid to Snell Farms. Mr. G. wrote to Union Oil on June 17, 1977 and again on July 25, 1977, indicating that Mr. Stewart had disposed of his interest in the royalty with respect to the leases but had lost his documentation. He asked for copies of the leases, which were forwarded to him.

[93] In June 1982, the lessees were informed by counsel for Wheatland Farming Co. Ltd. that Snell Farms had changed the royalty payee to Wheatland. From the documentation, it appears that Mr. G. also notified at least one of the lessees on June 17, 1982 that royalties should be paid to Wheatland.

[94] According to representatives of Coastal and Bonavista, the ultimate lessees with respect to these two leases, neither Wheatland nor Snell raised any issues with them in relation to the royalty payments that they received. These royalties have been substantial - over $1.7 million from February 2001 to January 2011 paid by Bonavista alone.

[95] There is no evidence that James Stewart or Jerome Development ever raised any issues or concerns with respect to the fact that neither received any royalty payments under the Scurry Leases from 1977 onward. There is evidence that Mr. Stewart's accountant in Las Vegas received Alberta Energy Tax statements in 1985 for the taxation year 1983 referring to taxes payable with respect to mineral rights, which were the responsibility of the lessees to pay under the leases. These taxes were paid by the lessees. There is no evidence that Mr. Stewart or his accountant ever asked the lessees about these statements.

[96] Neither the Plaintiffs nor the Defendants called any witnesses from Snell Farms or Wheatland with respect to these documents, even after this issue had been raised during pre-trial questioning. The Defendants point out that on November 30, 2011, they provided the Plaintiffs with a "without prejudice" brief for a judicial dispute resolution in which the issues arising from these assignments were discussed. The judicial dispute resolution was held on December 8,

2011. On about December 9, 2011, Ms. Calder and Cody Stewart signed documentation that transferred the 50% interest held by the individual heirs of Mr. Stewart in the NE/4 of Section 25 to Jerome Development. Cody Stewart testified that she was called by a lawyer and told that this needed to be done to get things in order and that there were several benefits to doing this, including tax benefits. The certificate of title in relation to the NE/4 of the Section 25 Lands was amended on January 5, 2012, days before the trial commenced, reflecting Jerome Development as the interest holder, rather than Ms. Calder, Cody Stewart, James Stewart and Morgan Stewart.

G. Robert Copley and the Copley Group

[97] Robert Copley is the brother-in-law of Karen Nell Copley and the brother of Margaret Alice Demers, Goldie Alberta Danielsen and Mary Jane Biggar. Mr. Copley knew the grandparents and some of the parents of the other Plaintiffs but had never met them. Mr. Copley shares in an interest in the NW/4 of the Section 25 Lands and, thus, the Imperial NW/4 Lease with his siblings, who inherited their interests from their father's estate.

[98] His interest and the interest of his siblings (the "Copley Group") in the NW/4 lands are subject to a caveat held by Computershare, a gross royalty trust that distributes royalties from the 7-25 Well to family members holding units in the trust.

[99] Mr. Copley became involved in the present litigation after speaking with Mr. Lore of FSI. Mr. Lore visited Mr. Copley and told him that since the 7-25 Well had been out of production for more than 90 days, the original lease had expired. Mr. Copley had previously received calls from Mr. Oneil and Mr. Erickson, but had told Mr. Oneil he was not interested in the litigation. After his conversation with Mr. Lore and receiving legal advice, Mr. Copley and the other interest holders in the Imperial NW/4 Lease entered into a supplemental agreement with FSI stated to be effective May 9, 2005 that is substantially similar to the other supplemental top lease agreements. It is not clear when the agreement was actually signed, but the affidavits of execution on the top lease are dated September 2008. It was Mr. Copley who negotiated the higher royalty rate with FSI that benefited all the other freehold lessors.

H. Laurel Lee McLaren and the Irwin Group

[100] Ms. McLaren holds a one-third interest in the Union NE/4 Lease of the Section 25 Lands. Her aunts, Edna Keam and Wilma Marshall, also each own a one-third interest. Ms. McLaren is named as a Plaintiff in this action as the executrix of the estate of her mother, Betty Blanche Carter. Ms. Carter, Ms. Keam and Ms. Marshall all obtained their interests in the NE/4 lands upon the passing of their mother, Jean Ella Irwin, signatory to the Union NE/4 Lease as executrix of the estate of William James Irwin.

[101] Ms. McLaren's interest was not actually transferred to her as executrix of her mother's estate until June 23, 2010, long after the litigation had been commenced.

[102] Ms. McLaren had very little knowledge of the Section 25 Lands until her mother's passing in April 2005. Shortly thereafter, Ms. McLaren was contacted by Mr. Erickson of FSI,

who explained the litigation and FSI's role in it. At this point, the Statement of Claim filed by the remaining Plaintiffs listed the Irwin family members (the "Irwin Group") as Defendants. Ms. McLaren agreed to the top lease agreement and to join the litigation as a Plaintiff. Ms. McLaren and her aunts, or their representatives, signed the FSI documentation in late September and early October 2007, on the understanding that FSI would assume the top lease should this litigation be successful. The statement of claim was amended on December 5, 2005 to add Ms. McLaren, Ms. Keam and Ms. Marshall to the list of Plaintiffs and remove them as Defendants. Supplemental agreements were signed in late spring, 2008.

[103] Under cross-examination, Ms. McLaren stated that she did not have any concerns with Coastal's performance under the Union NW/4 Lease in the period after her mother's passing. She continued to accept royalty cheques in her mother's name, and later in her own, and did not ask Coastal about any periods of non-production until her discussion with Mr. Erickson in the summer, 2005.

[104] Ms. McLaren also acknowledged that she had not received independent legal advice before signing the FSI top lease and litigation agreements. At the time she entered into the agreements, she understood from FSI that the lease held by Coastal was invalid and the new lease with FSI now governed natural gas production on the NE/4 lands. Ms. McLaren never contacted Coastal after entering into the FSI agreements. She ceased cashing royalty cheques from Coastal until an agreement among counsel was reached on March 19, 2007 to the effect that the payment of royalties by Coastal to the Irwin Group following the date of service of the statement of claim did not constitute any form of acceptance, acquiescence, condonation or waiver by the royalty payees or prejudice or affect Coastal's allegation that the payment and acceptance of royalties prior to service of the statement of claim did constitute acceptance, condonation and waiver such that the royalty payees were estopped from challenging the lease.

I. 1088924 Alberta Ltd.

[105] The original top lease agreements entered into in 2004 with the various lessor families are with FSI. In 2004 and 2005, 108 filed caveats alleging a contingent interest in Section 25, although it was not a party to the top lease agreements. After May 24, 2007, when a decision with respect to damages in *Freyberg v Fletcher Challenge Oil & Gas Inc*, 2007 ABQB 353, 428 AR 102 was released by the Alberta Court of Queen's Bench ("*Freyberg* Damages Decision"), the top lease agreements were amended, but, as has been noted previously, the supplemental agreements were back-dated to 2004 and 2005. 108 was not a party to these supplemental agreements, but filed further caveats to register its alleged contingent interest. On January 28, 2009, 108 was added as a Plaintiff to this action with the consent of the Defendants, subject to the proviso that any defences based on limitations periods were expressly preserved.

III. PRELIMINARY ISSUES

[106] The Defendants raise a number of preliminary issues that they submit result in the Plaintiffs' action being fatally flawed. It is useful to resolve these issues before the core issue of

the validity of the leases, as their resolution has an impact on the parties before the Court and the evidence that informs the lease validity issue.

[107] The Defendants submit that:

a) the Jerome Group plaintiffs are not the proper parties to seek a declaration that the Scurry Leases have terminated;

b) 108 has no standing before the Court;

c) a number of the claims are barred in whole or in part by reason of the *Limitations Act*; and

d) several of the claims are barred in whole or in part by the doctrines of estoppel, laches or acquiescence.

[108] The Defendants also submit that the top lease Plaintiffs have engaged in wrongful conduct, and champerty and maintenance. They have counterclaimed, alleging set-off, champerty and maintenance, and interference with contractual relations. They also submit that a great deal of trial evidence relating to the historical conduct of the lessees with respect to the 7-25 Well is irrelevant to the issue of the validity of the leases.

A. Preliminary Issue 1: Are the Jerome Group Plaintiffs proper parties to the litigation?

a. Overview

[109] The Defendants submit that the Jerome Group Plaintiffs have not established that they are the proper parties to seek a declaration that the Scurry NE/4 Lease and the Scurry SE/4 Lease have terminated. For the reasons set out below, I agree. The Plaintiffs' application for declarations that the Scurry NE/4 Lease and the Scurry SE/4 Lease have terminated must fail on the basis that Snell Farms and Wheatland, whose rights may be affected by the declarations sought, are not parties before the Court in this litigation. The Court is unable to effectively adjudicate the issue of who are the current lessees under these leases in the absence of submissions from these interested parties. Thus, the Plaintiffs are unable to establish on a balance of probabilities that the Jerome Group Plaintiffs are the proper parties entitled to seek such declarations.

b. Arguments and Analysis

[110] The Plaintiffs raise the following arguments to support their position that this Court should proceed to make the declarations sought:

1. The absence of Snell Farms and Wheatland has no bearing on the issues;
2. The onus of naming Snell Farms and Wheatland as parties is on the Defendants;

3. The assignments are invalid;
4. The Defendants have adduced inadequate evidence with respect to Wheatland;
5. The principle of indefeasibility of title settles the issue;
6. The evidence is limited with respect to its admissibility;
7. The Defendants have no standing to enforce the assignments;
8. The issue was not properly raised by the pleadings;
9. The assignments are hearsay evidence; and,
10. Snell Farms and Wheatland have failed to file caveats.

[111] Each of the Plaintiffs' arguments is addressed below.

1. The absence of Snell Farms and Wheatland has no bearing on the issues

[112] The Plaintiffs submit that the presence or absence of Snell Farms and Wheatland in this litigation would have no bearing on the outcome of the core issue of whether the leases terminated for want of continuous production, since neither company had any involvement in the decision to shut-in the 7-25 Well. This, of course, begs the question of whether Snell Farms and/or Wheatland, as the putative holders of the leases and the beneficiaries of royalties, wish to have the leases declared invalid or, if they do, whether the Defendants may have defences to an application for declaratory orders specific to these entities. There is simply no properly admissible evidence before me on the positions of these absent parties. As the Court of Appeal noted in *Alberta (Treasury Branches) v. Ghermezian,* 2000 ABCA 228, 226 AR 170, I cannot be "perfectly certain" that I will be able to effectively adjudicate all issues relating to the assignments and the validity of the leases without Snell Farms and Wheatland as parties to the action: paras 19-20.

[113] There was a late attempt to address this issue. On April 25, 2012, the Plaintiffs brought an application to reopen their case to lead evidence with respect to what they alleged were new developments involving Snell Farms. This was after eighteen days of trial and after the Plaintiffs had closed their case, other than for the limited purpose of calling evidence from experts whose reports had been previously disclosed to the Defendants: see *Stewart Estate v TAQA North Ltd,* 2012 ABQB 87. Not surprisingly, the Defendants were opposed to this application, and advised the Court that a full hearing into this issue would be required, that cross-examination on the affidavit sworn by Mr. Lore in support of the application would be necessary, and that it was likely questioning of certain other witnesses and possible witnesses would be required. The Defendants were harsh in their criticism of the nature of the new evidence that the Plaintiffs sought to admit, and alleged that Mr. Lore had failed to be candid with the Court in his previous trial testimony with respect to his involvement in any attempts to adduce new evidence.

[114] Counsel for Bonavista and Coastal submitted that if the application to admit new evidence was granted, it would change the whole nature of the case, and would require a lengthy delay, further examinations, amendments to pleadings and possibly a new trial. They asserted that granting the Plaintiffs' application would result in grave prejudice to their clients. They asked the Court either to dismiss the Plaintiffs' application summarily, or to allow them additional time to prepare to address it. The Defendants who are not directly involved in the

Scurry NE/4 Lease and the Scurry SE/4 Lease also made strong submissions about the impact of this proposed new evidence on the trial process, the prejudice to their clients of further delay, and what they submitted was the tainted and suspicious nature of the proposed new evidence. They referred to the possibility of a mistrial and argued that admission of the evidence in the circumstances of this case would bring the administration of justice into disrepute. They asked that I dismiss the Plaintiffs' application summarily.

[115] In response, counsel for the Plaintiffs indicated that, while he was personally affronted by some of the submissions made by counsel for the Defendants, his instructions were to withdraw the application to adduce fresh evidence, as his clients were not prepared to risk further delay.

[116] In short, the application was withdrawn, and I made no ruling on it. The proposed new evidence was never admitted at trial.

[117] In final argument, the Plaintiffs submit that since the Defendants objected to them calling this fresh evidence during the trial, they cannot fairly argue that the Plaintiffs' case should not succeed for not having brought Snell Farms before the Court. However, the objections of the Defendants to the alleged fresh evidence were two-fold: the timing of the application after years of preparation for trial and the closure of the Plaintiffs' case at trial, and the form of the proposed evidence and the circumstances under which it was obtained. They are not by any principle of equity precluded from continuing to assert that the proper parties to the litigation are not before the Court, as they did before the application to adduce fresh evidence was brought.

[118] The Defendants submit that the episode reflects on the credibility of Mr. Lore. The Plaintiffs in response suggest that, since these allegations with respect to credibility have been made, I should take into account the proposed new evidence, despite the fact that their application to adduce it was withdrawn. That would be entirely unjustified. The allegations about Mr. Lore's credibility relate to what the Defendants suggest is inconsistent evidence with respect to his involvement in attempting to obtain the proposed new evidence and his testimony at trial a few weeks earlier. As it happens, Mr. Lore's credibility is not an issue in this trial. While he may be concerned about the allegations, I do not need to make any findings on this specific issue that may affect him.

2. *The onus of naming Snell Farms and Wheatland as parties is on the Defendants*

[119] The Plaintiffs submit that the onus was on Bonavista and Coastal to name Snell Farms and Wheatland as parties to the litigation, or to adduce evidence beyond what has been adduced by the Defendants to address the issues relating to the assignments.

[120] In response to the Plaintiffs' implied assertion that they are the proper parties to seek the declarations they seek with respect to the validity of the leases, the Defendants have adduced evidence in the form of the assignments, correspondence relating to the assignments and their conduct in paying royalties to Snell Farms and Wheatland for close to 35 years to cast doubt on that assertion with respect to the Scurry Leases. The Defendants have the evidentiary burden of

establishing on a balance of probabilities that there are parties who are interested in the issue of the validity of the Scurry Leases that are not before the Court, and they have satisfied that evidentiary onus. Once they have done so, the onus shifts back to the Plaintiffs to refute the validity of the assignments on a balance of probabilities and to satisfy their burden of demonstrating that the parties before the Court are the only interested parties. They have not done so.

[121] The same reasoning applies to the suggestion by the Plaintiffs that Coastal and Bonavista should have brought Snell and Wheatland into the litigation through third party notices. It is not Coastal or Bonavista who seek a declaration that the leases have terminated; it is the Plaintiffs.

[122] It is important to note that it is not necessary, nor would it be appropriate, for this Court to decide with finality either the issue of the validity of the Scurry Leases or the issue of the validity of the assignments to Snell Farms and/or Wheatland in the absence of those parties. In response to the Plaintiffs' application for declaratory relief with respect to the Scurry Leases, the Defendants need only establish that there are interested parties that are not before the Court. They do not need to prove the validity of the assignments.

[123] The Plaintiffs submit that where the subject matter of an allegation lies particularly within the knowledge of one of the parties, that party must prove it. The Defendants Bonavista and Coastal have presented evidence from their files to establish the existence of other parties interested in the leases by virtue of the assignments. It is the Plaintiffs who assert that they are the proper lessors. Given that the assignments involved Mr. Stewart as assignor, information with respect to the validity of the assignment must lie particularly within the knowledge of the Jerome Group. The difficulty posed by Mr. Stewart's death does not shift this burden to the Defendants. In fact, the evidence of Ms. Calder, other than with respect to her suspicions about the validity of the assignments, supports the validity of the assignments. Ms. Calder thought her father no longer had any interest in Section 25, and from her review of her father's affairs as executrix, she had no reason to believe otherwise. She heard from Montreal Trust in 1995 that royalty payments were being paid to Snell Farms and, until persuaded otherwise by Mr. Erickson, the Stewart family had no reason to believe they were still valid lease holders with respect to the Section 25 Lands.

3. *The assignments are invalid*

[124] The Plaintiffs submit that since Mr. Stewart transferred all of his interest in the SE/4 of Section 25 and half of his interest in the NE/4 of Section 25 to Jerome Development in 1972, he could not assign any interest in the SE/4 Lease to Snell Farms in 1977 because he no longer owned such interest.

[125] Coastal and Bonavista argue that this misses the point; that they have never asserted that Mr. Stewart assigned his fee simple interest in Section 25 to Snell Farms. They point out that it is a basic principle of oil and gas law that leasehold interests are separate and distinct from fee simple interests: *Scurry Rainbow Oil Ltd. v Kasha* (1996), 184 AR 177, 39 Alta LR (3d) 153 (CA) at para 25. The Court of Appeal in *Kasha* notes that, after a lease, the lessor has three kinds

of legal interests in the land and minerals: the surface interest, the right to receive rents and royalties under the existing lease and a reversionary interest in the minerals in place, contingent upon the termination of the existing lease.

[126] Justice O'Leary noted that a court should follow a "two-step approach" to a determination of the nature of an interest assigned subsequent to a lease: *Kasha* at para 28. The first is to characterize the interest retained by the lessor following the lease over and above the fee simple interest in the reversion. In *Kasha,* that interest only consisted of the right to receive royalties, as there was no surface interest. In this case, Mr. Stewart retained both the surface interest and the right to receive rents and royalties under the Scurry Leases. The second step is thus to examine the transfer to Jerome Development to determine what it conveyed.

[127] The Plaintiffs submit that when Jerome Development acquired its interests in 1972, it also acquired Mr. Stewart's lessor interests under the two Scurry Leases. The Plaintiffs refer to the (partially) printed words of the land titles form that was used by Mr. G. on Mr. Stewart's behalf when the transfer to Jerome Development took place, to the effect that it was a transfer of "all of my estate and interest in the said parcel of land". The Defendants submit that there is no evidence that Mr. Stewart intended to sell his rights to receive the leasehold rents and royalties by this transfer. Evidence that he did not advise the lessors of a change of payee to Jerome Development in 1972 nor comply with the terms of the leases that require evidence of the assignment to be provided to the lessors is indicative of the contrary, as is the fact that he appears to have formally assigned his interests in the leases to Snell Farms in 1977 by way of assignments that include the representation that he had the power and authority to assign the leases. It is also noteworthy that notification of these later assignments was given to the lessees, and that Jerome Development, through its operating mind Mr. Stewart, never sought royalties from the lessors after the transfers of 1972.

[128] However, it is not necessary or appropriate that I decide with finality whether Mr. Stewart was incapable of assigning his leasehold interests to Snell Farms because of an earlier transfer to Jerome Development without the benefit of submissions by parties with an interest in that issue, Snell Farms and Wheatland. This argument cannot succeed in the absence of such submissions.

4. *The Defendants have adduced inadequate evidence with respect to Wheatland*

[129] The Plaintiffs submit that there is no evidence of any assignment of any interest in the Scurry NE/4 lease to Wheatland.

[130] There is documentary evidence indicating that counsel for Wheatland wrote to the then-lessees under the Scurry Leases on January 20, 1983 to advise that future payments and correspondence should be sent to Wheatland at a specific address, and changed that address on July 25, 1983. There is also evidence of a letter from Mr. G. on June 17, 1982 confirming a change of name respecting the royalty interests from Snell Farms to Wheatland. There is evidence that the lessees subsequently paid royalties to Wheatland without complaint from Snell

Farms, Jerome Development or Mr. Stewart. This is sufficient evidence to raise an issue with respect to whether a party with an interest in the issue has been joined in this proceeding.

5. *The principle of indefeasibility of title settles the issue*

[131] The Plaintiffs submit that, with the registration of land transfers to Jerome Development, Jerome Development's title became indefeasible pursuant to sections 60 and 203 of the *Land Titles Act*, RSA 2000, c L-4. These sections provide, in part:

> 60(1) The owner of land in whose name a certificate of title has been granted shall, except in case of fraud in which the owner has participated or colluded, hold it, subject (in addition to the incidents implied by virtue of this Act) to the encumbrances, liens, estates and interests that are endorsed on the certificate of title, absolutely free from all other encumbrances, liens, estates or interests whatsoever except the estate or interest of an owner claiming the same land under a prior certificate of title granted under this Act or granted under any law heretofore in force and relating to title to real property.
>
> ...
>
> 203(2) A person contracting or dealing with or taking or proposing to take a transfer, mortgage, encumbrance, lease or other interest from an owner is not, except in the case of fraud by that person,
>
> > (a) bound or concerned, for the purpose of obtaining priority over a trust or other interest that is not registered by instrument or caveat, to inquire into or ascertain the circumstances in or the consideration for which the owner or any previous owner of the interest acquired the interest or to see to the application of the purchase money or any part of the money, or
> >
> > (b) affected by any notice, direct, implied or constructive, of any trust or other interest in the land that is not registered by instrument or caveat, any rule of law or equity to the contrary notwithstanding.
>
> ...

[132] The Plaintiffs rely on the following comment in *Darnley v Tennant*, 2006 ABQB 575, 408 AR 261 at para 21:

> It is a fundamental premise of the land titles system that the owner under a title issued by the Registrar takes the land free of any unregistered interests, except in the case of fraud...
>
> > The object of the Act was to contain within its four corners a complete system which any intelligent man could understand, and which could be carried into effect in practice without the intervention of persons skilled in law. <u>The cardinal principle of the statute is that the register is everything, and that, except in cases of actual fraud on the part of the person dealing with the registered proprietor, such person, upon registration of the title under which he takes from the</u>

> registered proprietor, has an indefeasible title against all the world. [emphasis added]

[133] It is arguable that the indefeasibility of title referred to in this comment refers merely to the interest that has been transferred. In *Darnley*, the interest was clearly a surface interest in land, both with respect to what was registered and what was claimed. In this case, the extent of the interest Mr. Stewart intended to transfer to Jerome Development in 1972 is still an issue, one that should not be finally determined without giving Snell Farms and Wheatland standing to participate in the litigation.

[134] The *Darnley* decision is also relevant with respect to both the 1972 transfer and the recent transfers of Section 25 interests from the Stewart heirs to Jerome Development.

[135] In *Darnley*, Ms. Darnley and her husband had been the registered owners of a piece of land. On November 15, 2002, they agreed to sell a portion of this land to Mr. Tennant in the future if they did not require it. The letter of intent stipulated that if the Darnleys sold the land, the letter of intent would be presented and agreed to by the new buyer. However, on November 29, 2002, prior to the letter of intent being registered against title, the land was transferred into Ms. Darnley's name only.

[136] The Court found that Ms. Darnley was a *bona fide* purchaser for value and not a volunteer, as the transfer to her was part of a divorce settlement. However, the Court found that there was "something extra" that amounted to fraud under the *Land Titles Act* and that the situation thus fell within the exception to indefeasibility under section 60 of the *Land Titles Act*. First, Ms. Darnley was one of the covenators who created the interest in the land, and second, she granted Mr. Tennant an interest in the land when she was a joint owner of the land. The Court held that the interest was subject to the rights of Mr. Tennant, as Ms. Darnley had merely changed the quantum of her interest, and this was "something more" than mere knowledge of the interest.

[137] With respect to the 1972 transfer, Mr. Stewart, like Ms. Darnley, created the initial interest in land through the leases, and arguably, merely changed the nature of his interest from a personal interest to a wholly-owned family company, of which he was the operating mind.

[138] With respect to the recent transfer, Jerome Development had been the holder of 50% of the NE/4 of Section 25 since 1974, and the eleventh-hour transfer of the other 50% interest from Mr. Stewart's heirs to Jerome Development effective January 5, 2012 simply changed the quantum of its interests (and, in effect, merely changed the manner in which Ms. Calder and Cody Stewart owned their interests).

[139] The decision of the Alberta Court of Appeal in *Lanstrom Developments Ltd v Passburg Petroleums Ltd* (1984), 53 AR 96, 30 Alta LR (2d) 379 (CA), is also relevant to the issue of indefeasibility of title.

[140] Although the facts of that case are distinguishable and the ultimate issue was different from the issue here, the Court of Appeal commented on whether a registered owner had as much right to rely upon title as a third party about to deal with the registered owner.

[141] The Court of Appeal noted that it was clear that unregistered interests may exist independent of the register under the Torrens system: para 12. Justice Moir referred to a Supreme Court of Canada decision where a party claiming under her father's will was in no better position than her father in terms of the recognition of an unregistered interest, thus making it clear that an unregistered interest may exist independently of the register between the immediate parties to the transaction or volunteers claiming through the immediate parties: *Re Church*, [1923] SCR 642, [1923] 3 WWR 405.

[142] As the individual members of the Jerome Group are volunteers, this case appears to answer the question of whether indefeasibility applies to their interest as acquired through the Stewart estate. Justice Moir noted that the reason for this rule is that a volunteer does not rely on the register, and "cannot use the Act to better his position. It is designed to protect third party purchasers for value": *Lanstrom* at para 17. He further said that the concept of indefeasibility applied only to situations where there is a need to rely upon the certificate of title: para 20.

[143] Given that the most recent transfers were between the Jerome Group, as volunteers, and a related party, Jerome Development, which had knowledge of the unregistered interests in question through the volunteers as operating minds of Jerome Development, there remains a real issue of whether the principle of indefeasibility of title would protect Jerome Development's interest, an issue that should not be decided without input from Snell Farms and Wheatland.

[144] In addition, the Defendants submit that the circumstances giving rise to this recent transfer, occurring as it did between the judicial dispute resolution proceedings and trial, could be considered "fraud" under the *Land Titles Act*. This was a transfer with nominal or no consideration in the face of knowledge of what appeared to be an unregistered interest held by parties not before the Court. The Court in *Darnley* recognized at paragraph 29 that a transfer without consideration could raise an inference of fraud.

[145] Ms. Calder and Cody Stewart testified that the transfer was recommended to them by either Mr. Lore or their counsel for a variety of reasons, including some unspecified tax considerations. It also appears from the evidence that the transfer may be related to a settlement agreement that the Plaintiffs entered into with CrossAlta, apparently on the eve of trial, relating to competing claims to the gas on Section 25 between CrossAlta and the current lessors. The settlement appears to include compensation payable to the Plaintiffs contingent on a final determination as to the validity of the **top leases**. It also appears from the documentation that the CrossAlta settlement agreement required the Jerome Group to make certain representations and warranties about title to the Section 25 Lands, leading to an inference that the transfer was in part an attempt to bolster the indefeasibility of title argument. While the transfer may well have been done with the advice of counsel, that does not detract from its purpose.

[146] At any rate, this is an issue that affects Snell Farms and Wheatland and should not be determined without their presence before the Court.

[147] The recent transfer and the circumstances under which it took place give rise to another concern with respect to the Plaintiffs' applications for declaratory relief. In *Hongkong Bank of Canada v Wheeler Holdings Ltd*, [1993] 1 SCR 167 at paras 36-40, Sopinka, J. noted that in exercising discretion about whether or not to grant a declaration, a court may take into account equitable principles, including the conduct of the party seeking the relief. The transfer, and the implications it may have on the validity of the assignments between Mr. Stewart and Snell Farms and subsequently Wheatland, are issues that involve Snell Farms and Wheatland, and should not be determined without these entities as parties to the litigation. A transfer in the face of knowledge of these interests raises concerns about the conduct of the Plaintiffs and whether equitable principles should preclude the relief sought.

6. *The evidence is limited with respect to its admissibility*

[148] The Plaintiffs submit that the letters received by the lessors from Mr. G. and counsel to Wheatland were admitted as exhibits at trial on a limited basis and that no weight ought to be given to them.

[149] These letters are business correspondence. In the case of the letters from Mr. G., they were sent by a person now deceased and received as a matter of course by employees of Union Oil and Scurry Rainbow in 1977 and 1982. In the case of the letters with respect to Wheatland, they were sent by lawyers from the MacKimmie Matthews law firm to Scurry Rainbow and Union Oil in 1983.

[150] The issue of necessity clearly arises with respect to the correspondence from Mr. G. While it may have been possible to call the former MacKimmie Matthews lawyers to give evidence with respect to sending the letters in 1983, it is difficult to imagine that they would have been able to testify with respect to their recollections of the specific correspondence in a manner that would add to reliability.

[151] I accept the letters as providing an explanation for the conduct of the lessors in directing all future correspondence, notices, payments and royalties to Snell Farms and later to Wheatland. I find that this evidence corroborates the evidence of the assignments.

7. *The Defendants have no standing to enforce the assignments*

[152] The Plaintiffs submit that the Defendants have no standing to enforce a contract between Snell Farms and Mr. Stewart. That is not the Defendants' purpose in adducing evidence of the assignments; they were tendered to counter the Plaintiffs' implied assertion that the Jerome Group are the lessors by inheritance of the Scurry Leases and the proper parties to call for declaratory relief respecting the leases.

[153] The Plaintiffs, however, submit that because the Defendants are not privy to the assignments, they have no standing to set them up as a defence to claims for declaratory relief. This submission has no basis at law, and relies on a skewed interpretation of the doctrine of privity of contract. The Court of Appeal's decision in *Ghermezian* is one example of a situation where a non-party to a contract was able to assert successfully that the principal parties should be before the Court before declaratory relief with respect to a contract is granted.

8. The issue was not properly raised by the pleadings

[154] The Plaintiffs submit that the issue of the assignments was not properly raised in the pleadings of Bonavista and Coastal.

[155] The Plaintiffs argue that, although the Bonavista and Coastal pleadings raise the assignment of the Scurry NE/4 Lease to Snell Farms in response to the Plaintiffs' allegation that the lease terminated because royalties were not paid to Jerome Development and Ms. Calder, the Defendants should have raised the assignment as a defence to the Plaintiffs' claim that the lease terminated due to a cessation in production. The Plaintiffs point out that the issue of the assignments was not raised with respect to the Scurry SE/4 lease. They submit that the Defendants should have been specific in pleadings by giving notice to the Plaintiffs that they would be arguing that not all interested parties were before the Court.

[156] It cannot be said that the Plaintiffs were not aware from the pleadings that the Defendants were alleging an assignment of at least the Scurry NE/4 Lease to Snell Farms early on in the litigation, and at least from the date of the judicial dispute resolution with respect to the Scurry SE/4 Lease. While the pleadings could have been more specific, it does not change the fact that all interested parties are not before the Court, and the Court's decision with respect to whether it is appropriate to proceed in that case is not solely dependent on the pleadings. The possibility of an error in pleading does not address the prejudice to third parties and the possibility of injustice that underpin the general rule requiring all interested parties to be before the Court.

9. The assignments are hearsay evidence

[157] The Plaintiffs submit that the assignments are hearsay evidence, that they do not meet the tests of reliability and necessity, and that they are "rife" with errors and deficiencies.

[158] The assignments were adduced in evidence under the terms of an agreement of counsel with respect to Agreed Trial Exhibits. Under that agreement, the assignments are deemed to be authentic and the signatures on the records are deemed to be genuine. The records are deemed to have the same effect as if each had been identified and authenticated by a witness under oath. Absent evidence to the contrary, they are deemed to have been prepared on or about the dates shown on the face of the assignments. The parties agreed that the records were not admitted for the truth of their contents and that any weight to be given them shall be determined by the trial judge.

[159] The assignments are the only direct evidence adduced at trial that Merville Stewart assigned the two Scurry Leases. The only evidence that casts doubt on the assignments is Ms. Calder's testimony about her "suspicions" about whether her father would ever have assigned mineral rights, her poor opinion of Mr. G., the 1972 transfer and the 1974 Certificate of Title (which were prepared and filed by Mr. G.). The assignments are corroborated by evidence of correspondence with the lessors, the subsequent payment of royalties to Snell Farms and then Wheatland without complaint from Mr. Stewart or Jerome Development, and evidence of the consensus of Mr. Stewart's friends (and family, prior to their contract with FSI) that Mr. Stewart no longer had any interests in property or assets in Alberta.

[160] The Plaintiffs' submission that the assignments are deficient rests on certain ambiguities arising from the printed words of the form towards the end of the assignments. Following the terms previously described, the printed form reads as follows:

> THE ASSIGNOR [Mr. Stewart] doth hereby grant and assign unto the Assignee [Snell Farms] ALL AND SINGULAR <u>the lands and premises comprised in and demised by the lease.</u>
>
> TO HOLD the same unto the Assignee [Snell Farms] <u>for the sole and only purpose of mining and operating for petroleum and natural gas</u>, and of laying pipe lines, and of building tanks, stations and structures thereon, necessary and convenient to take care of the said products <u>for the residue now unexpired of the said term of twenty-one years, created by the lease, and every renewal thereof, subject to the payment of rent and royalties</u> and the performance and observance of the covenants, conditions and stipulations in the lease reserved and contained, and henceforth on the Lessee's part to be paid, performed and observed. (emphasis added)

[161] This is indeed confusing language, and likely arises from the use of an inappropriate printed form adapted to the situation between Mr. Stewart and Snell Farms. This language however, does not derogate sufficiently from the interpretation that the assignments, read as a whole, were intended, and did, transfer Mr. Stewart's interest in the Scurry Leases to Snell Farms, such that I should given the assignments no weight. A court may look to the subsequent conduct of the parties to aid in the proper interpretation of the contractual language in the light of any ambiguities that may arise from this language: *Kasha* at para 45. In the present case, such conduct supports the interpretation of the assignments suggested by the Defendants. The interpretation of this language suggested by the Plaintiffs would give rise to a commercial absurdity and contradictions on the face of the assignments, and such an interpretation should be avoided.

[162] The Plaintiffs also note that the Agreement for Sale documentation referred to in the assignments was not produced in the litigation. These documents, to the extent they can be found, would be in the control of either the Stewart family or Snell Farms to produce. There was no evidence that they were impossible to produce or that they did not exist. There is nothing in

the evidence adduced to this point to indicate that this documentation would derogate from the effect or validity of the assignments.

[163] It is, however, not appropriate to make a finding with respect to the proper interpretation of these assignments without input from Snell Farms and Wheatland. What the Defendants have done in adducing this evidence is to raise an issue as to whether the Plaintiffs are the proper or sole interested parties in the leases that these assignments refer to, and the Plaintiffs have not been able to establish otherwise on a balance of probabilities.

10. Snell Farms and Wheatland have failed to file caveats

[164] The Plaintiffs submit that the failure of Snell Farms and Wheatland to file caveats to protect their interests affects the validity of the assignments.

[165] Coastal and Bonavista submit that the absence of caveats filed on behalf of Snell Farms or Wheatland prior to the recent transfer to Jerome Development is entirely irrelevant to Jerome Development with respect to its 100% interest in the SE/4 and 50% interest in the NE/4 of Section 25. When Jerome Development acquired certain interests in 1974, the assignments had not yet occurred. Jerome Development acquired whatever mines and minerals interests it acquired subject to the Scurry lessees' caveats registered on title at that time, and Coastal and Bonavista submit that Jerome Development, through its operating mind Mr. Stewart, knew that it was not acquiring an interest in those leases at the same time. They argue that Jerome Development knew of the Scurry Leases because: (a) Mr. Stewart was the lessor under both of them and did not assign the leases to Jerome Development; and (b) caveats were registered on those titles. Further, Jerome Development had corporate knowledge through Mr. Stewart of the assignments in 1977. Coastal and Bonavista submit that the fact that Snell and Wheatland did not file caveats is as irrelevant as Mr. Stewart himself not filing caveats.

[166] This state of affairs, and the corporate knowledge of Jerome Development, has remained the same from that time to the present. I agree that whether or not Snell Farms or Wheatland filed caveats could not have had any impact on Jerome Development and could not have changed anything insofar as concerns Jerome Development. Jerome Development can be in no better position today than it was the day the assignments were entered into to argue that Snell Farms has no interest in the Scurry Leases and the matters raised in this litigation. Unregistered interests can exist independently of the land titles registry: *Lanstrom* at para 12. Snell and Wheatland appear to have *contractual* rights and interests created by the assignments, and these interests can exist independent of the land titles registry. As indicated in *Lanstrom*, a volunteer is in the same position as the registered owner who may have created and sold unregistered interests. Such a volunteer cannot rely on the caveat provisions of the *Land Titles Act* to better its position, as these provisions were designed to protect third party purchasers for value: *Lanstrom* at para 17.

[167] The Defendants submit that, at any rate, if Snell Farms and Wheatland were parties before this Court, they would be entitled to rely on caveats filed by the lessors, citing *Hughes v Gidosh* (1970), [1971] 1 WWR 641 (Alta SC). While *Hughes* is distinguishable from this case

on its facts, the finding in *Hughes* that is relevant is that a caveat filed in support of a lease protects, by implication, the rights of the lessor as well as the lessees and constitutes notice to the world of the terms of the lease. In *Hughes*, the Court held that the lessor did not have to file a caveat to protect a reversionary interest in the lease when transferring its other interests in the land. If Snell Farms and, later, Wheatland are thus put in the position of lessors by reason of the 1977 assignment, they should be in no worse situation than Mr. Stewart as the original lessor, nor be required to protect their interest against Mr. Stewart by caveat.

[168] As noted by the Defendants, the assignments purport to bind Mr. Stewart's heirs and assigns, and the Jerome Group freeholders and Jerome Development, which had knowledge of the assignments through its directing mind, should be in no better position than Mr. Stewart to require the assignees to caveat their interest.

[169] There is no unrelated third party here, acquiring an interest while relying on the registered title, and even if there were, the caveats filed by the original lessee would provide notice of the leasehold interests. The principles with respect to unregistered interests set out in *Lanstrom* are relevant to this issue.

[170] Again, this is an issue that requires the input of the affected parties, Snell Farms and Wheatland, and cannot be determined with finality in their absence. It is not, as argued by the Plaintiffs, so persuasive as to eliminate the requirement that all necessary parties to the issue be present before the Court.

c. Conclusion

[171] The Plaintiffs, as the parties who seek declarations that the leases have terminated, have the burden of demonstrating that the parties before the Court are "not only interested parties, but are the only interested parties to the application": Lazar Sarna, *The Law of Declaratory Judgments*, 3d ed (Toronto, Ont: Thomson Carswell, 2012) at 98.

[172] While it may be argued that this burden is ultimately for the benefit of the party that applies for a declaratory order, as it serves to ensure that the declaration sought will have practical effect, it does not follow that this Court should proceed to make such declarations at the applicant's urging in any event. The Plaintiffs disingenuously submit that they do not seek any relief against Snell Farms or Wheatland. However, what they seek are declarations that would affect the validity of leases that it appears from the evidence may have been assigned to Snell Farms and Wheatland, leases pursuant to which Snell Farms and Wheatland have received significant royalty payments from 1977 to the present.

[173] As noted by the Court of Appeal in *Ghermezian* at para 15, the purpose of the general rule that all parties to a contract must be before the court to enable it to fully address the issues is multi-fold:

> ... to ensure: (i) no injustice is done to any party to an action or other interested persons; (ii) the parties are not prejudiced by not having all proper parties before

> the court; (iii) all interested parties will be bound by the decision so there is no risk of subsequent proceedings by persons not before the court and thus avoid the need for multiple suits; and (iv) the court will be able to effectively adjudicate all issues in question ... The court must be "perfectly certain that no injustice is done, either to the parties before it, or to others who are interested in the subject matter"...

[174] The failure of the Plaintiffs to name Snell Farms and Wheatland as parties to this action is a fundamental and fatal flaw in their case with respect to the Scurry NE/4 Lease and Scurry SE/4 Lease.

[175] Originally, the Plaintiffs alleged that the Scurry Leases terminated because Bonavista and Coastal failed to pay royalties to the Jerome Group Plaintiffs. As their application for a declaration that the Scurry Leases terminated is dismissed because they have failed to establish that the Jerome Group Plaintiffs are the proper parties to seek such a declaration, so must any claims for termination on the basis of non-payment of royalties fail. In addition, it appears from their written argument that the Plaintiffs are no longer advancing that claim. Even if I am wrong and the Jerome Group Plaintiffs were able to establish that they are the current leaseholders, they failed to provide any notice of default under the leases to the lessors in accordance with Clause 19 of the leases.

B. Preliminary Issue 2: Does 108 have standing before the Court?

[176] 108 was added as a Plaintiff in this lawsuit in 2009, largely, the Plaintiffs submit, as a result of uncertainty in the law arising out of the damages decision in the *Freyberg* litigation: *Freyberg* Damages Decision. The FSI agreements and supplemental agreements were transferred to 108, which thus holds the top leases in trust for FSI, and has registered caveats.

[177] From the pleadings, 108's claim is based in trespass, conversion and unjust enrichment.

[178] However, the Plaintiffs at the trial took the position that claims for damages and disgorgement are properly advanced by the freeholder Plaintiffs and that 108 is to be compensated by contract out of any judgment recovered by them, conceding that under the FSI agreements and top leases, 108's rights to produce the gas do not arise unless and until there is a determination that the underlying leases are terminated.

[179] The Plaintiffs submit that, in the alternative, 108 may have a claim in compensation and damages for the loss or delay in being able to take possession of the lands and produce leased substances, arising from the fact that 108 filed caveats against the title to the Section 25 Lands, a loss arising, it is argued, from the Defendants' wrongful interference with 108 and FSI's economic rights.

[180] It is difficult to rationalize 108's argument, given that the FSI top leases clearly provide that they do not become effective until there has been a determination that the original leases have terminated. There is no basis for the claim for loss or delay.

[181] With respect to trespass and conversion, that remedy is only available to the owner or person in possession of personal property, and there is no evidence that 108 has any such right. 108 cannot have a claim in unjust enrichment since its interest, at best, is merely a contingent interest that may never come into effect.

[182] While each of the FSI agreements was assigned by FSI to 108 and 108 executed Declarations of Trust acknowledging that it held those interests in trust for FSI, this does not improve 108's position with respect to damages. While it may have standing in the Plaintiffs' claim for a declaration on lease validity, by virtue of its interest in the top leases, it has no claim for damages.

C. Preliminary Issue 3: Are some of the claims made by the Plaintiffs barred by the *Limitations Act*?

a. Overview

[183] The claims of the freeholder Plaintiffs in unjust enrichment, trespass and conversion are barred by the *Limitations Act*, on the basis that they, or their predecessors in interest, knew or ought to have known that the injuries complained of had occurred more than two years prior to seeking their remedial orders in that regard. The claims, if any, of 108 are similarly barred. The ten-year ultimate limitation period bars any claims that may have arisen from the Plaintiffs' allegations of historical discriminatory production practices and failure to drill in the Elkton zone.

b. The Limitations Act

[184] The parties agree that Section 3(1) of the *Limitations Act* governs this case in so far as the claims in unjust enrichment, trespass and conversion are concerned. Section 3(1)(a) provides that if a claimant does not seek a remedial order within two years after the date on which the claimant first knew, or in the circumstances ought to have known:

(a) that the injury for which the claimant seeks a remedial order had occurred (in this case, unjust enrichment, trespass and conversion);

(b) that the injury was attributable to conduct of the defendants; and

(c) that the injury, assuming liability on the part of the defendants, warrants bringing a proceeding;

the defendants are entitled to immunity from liability in respect of the claim.

[185] Section 3(1)(b) provides that the defendants are entitled to immunity if a claimant does not seek a remedial order within 10 years after the claim arose. This "ultimate limitation period" starts to run from the date the cause of action arose, and does not depend upon when the claimant

knew, or ought to have known, about the claim: *Bowes v Edmonton (City)*, 2007 ABCA 347, 425 AR 123 at para 151.

[186] A "claim" is a matter giving rise to a civil proceeding in which a claimant seeks a remedial order. A "remedial order" is defined, in the context of this case, as "a judgment or order . . . requiring a defendant . . . to pay damages for the violation of a right." Declarations of rights and duties or legal relations are expressly excluded from the definition of "remedial order" under the *Limitations Act*, and thus the *Limitations Act* does not apply to the Plaintiffs' applications for declaratory orders with respect to the status of the leases. However, remedial orders ancillary to a declaration are not excluded. An "injury", in the circumstances of this case, can mean economic loss, the non-performance of an obligation or the breach of a duty, being the obligation or duty to surrender the lease upon its termination and vacate the land.

c. Two-year Limitation Period

[187] The Defendants submit that the freeholder Plaintiffs (other than the Jerome Group) knew or ought to have known shortly after July 1995, when production at the 7-25 Well ceased and production royalty payments stopped and were replaced by annual shut-in royalty payments, that there was a cessation of production that would trigger a termination of the lease unless the Third Proviso applied. They submit, therefore, that the claims for damages are barred by virtue of the *Limitations Act*, section 3(1)(a), in that the freeholder Plaintiffs failed to seek a remedial order within two years of that date. This argument cannot be made with respect to the Jerome Group Plaintiffs, since they were not receiving royalties in 1995, but since they have been unable to establish that they are the proper parties to seek a declaration that the Scurry Leases have terminated, it follows that there can be no determination of their claims to damages.

[188] The remaining Plaintiffs submit that the first time any of them had any knowledge or understanding that there was an issue as to the validity of the leases by virtue of a cessation of production was in December 2003, when Mr. Oneil met with counsel who raised that as a the possibility. The Statement of Claim was filed on August 9, 2005.

[189] In *James H Meek Trust v San Juan Resources Inc*, 2005 ABCA 448, 376 AR 202, lessees under an oil and gas lease had failed to pay royalties under a royalty trust agreement from 1988 to 2002. The trial judge found that beneficiaries of the royalty trust were unaware that royalties were not being paid on specific wells until they were notified of that fact by the then owner of the wells in 2002. They brought their action for unpaid royalties soon thereafter.

[190] The issue was whether the beneficiaries ought to have known within two years of bringing their claim that the injury for which they were seeking a remedial order had occurred. According to Hunt, J.A., the test for "ought to have known" discoverability is "reasonable diligence" analysed in the light of the three section 3(1)(a) factors: *Meek* at para 21. In *Meek*, the only factor at issue was whether the beneficiaries "ought to have known" of the injury. The Court upheld the trial judge's finding that, given that the monthly statements provided to the beneficiaries did not provide particulars of the wells on which the royalty was being paid, they could not have known of the injury. Justice Hunt made it clear that section 3(5) of the

Limitations Act allocates the burden of proof of the section 3(1)(a) factors to the claimants, but found that in the circumstances of that case, they had discharged the burden: *Meek* at paras 27-31.

[191] The Plaintiffs submit that none of them had oil and gas experience nor any reason to suspect before Mr. Oneil's meeting with counsel that the leases had terminated.

[192] On the issue of their experience, the Plaintiffs refer to comments in *Meek* where the Court discusses the beneficiaries' lack of experience with the oil and gas industry. Those comments must be put in the context of the factual finding in the case that, due to the nature of the monthly disclosure they were receiving, the beneficiaries could not have known of the failure to pay royalties on particular wells.

[193] In this case, the freeholder Plaintiffs, or their predecessors in interest, would have stopped receiving monthly production royalty cheques, which were replaced by annual shut-in royalty payments. There is evidence that at least Mr. Oneil and Betty Cardiff, who acted as agent for the Irwin Group, were aware of the difference. Ms. Baxter-Gilmour testified that her mother had written to Nexen in early 2002 asking why no royalties had been received when it appeared that the 7-25 Well was again active. The Plaintiffs' situation is thus different from that of the beneficiaries in the *Meek* case, who did not have any reason to suspect a problem with their royalty payments. The issue, therefore, is whether knowledge that production under the lease has ceased, gained through the cessation of production royalty payments and the receipt instead of annual shut-in royalty payments, is sufficient to satisfy the "ought to have known" test under section 3(1)(a).

[194] Key to this issue is the concept of "reasonable diligence". The Plaintiffs refer to *H(VA) v Lynch*, 2000 ABCA 97, 255 AR 359 on the issue of reasonable diligence, implying that it supports their argument that they had no obligation to consider the validity of the leases until 2003 and 2004. *Lynch* was an appeal of an order of summary judgment dismissing an action on the basis that it was barred by the previous *Limitation of Actions Act*, RSA 1980, c L-15. The Plaintiff made claims in false imprisonment, assault, battery and medical malpractice arising from her detention in the psychiatric unit of a hospital sixteen years before she brought her action. In *Lynch*, Wittmann, J.A. allowed the appeal with respect to the claims of false imprisonment, assault and battery on the basis that there was a triable issue with respect to whether there had been concealment of some of the facts that were relevant to these causes of action that had not come to light until the Plaintiff obtained a copy of her hospital records many years later. The Plaintiff alleged that she had been told she could not be discharged from hospital except with the permission of her doctors, while the hospital records indicated that, in that respect, the Defendants had not followed the proper procedure set out by relevant legislation. The Plaintiff also alleged a fiduciary relationship with her doctors, which was a genuine issue for trial.

[195] In that case, the Court found that the Plaintiff's failure to obtain her hospital records was not a failure of reasonable diligence, since, given that the Defendants told her that they had authority to detain her, there was no evidence that ought to have put her on inquiry: para 39.

Thus, given the possibility of fraudulent concealment of causes of action and the question of a fiduciary relationship, the limitations defences were not bound to succeed without the necessity of a trial.

[196] However, the Court dismissed the appeal of an order of summary judgment with respect to the Plaintiff's claims of medical malpractice and negligence, finding that such claims did not hinge on the finding of an absence of authority to detain or a representation to that effect: para 50. Since the Plaintiff knew all the material facts on which her claim in malpractice was based at the time of her release from hospital, the doctrine of discoverability did not apply: para 52.

[197] In this case, the remaining freeholder Plaintiffs knew or ought to have known that production had ceased under the leases shortly after July 1995. By the end of November 1995, they ought reasonably to have known that production had ceased for more than 90 consecutive days. In the result, they knew or ought to have known by that time all the facts necessary for their claim that the leases had terminated in accordance with their terms. They thus should have known of the "injury" that is the subject of the claims of unjust enrichment, trespass and conversion.

[198] The Plaintiffs argue that they did not at that point know that the cessation of production was <u>not</u> for a reason allowed by the Third Proviso. The Defendants' reliance on the exceptions to termination set out in the Third Provisos is a defence to the Plaintiffs' allegations of termination and not a necessary part of the Plaintiffs' claims. At any rate, it is the "injury" that is key to what the plaintiffs ought to have known, and not the elements of the cause of action: *Sun Gro Horticulture Canada Ltd v Alberta Metal Building Sales Inc*, 2006 ABCA 243, 397 AR 282 at para 11.

[199] The Plaintiffs appear to acknowledge this in their argument with respect to onus in this litigation, submitting that all they have the burden to establish was that there was no production or operations for a period of some five-and-one-half years, and the onus of proving an exception to termination then falls on the Defendants.

[200] Even if the Plaintiffs did not know a fact material to the injury in not knowing the reason for the cessation of production, they were not entitled to ignore the issue until they were notified of the reasons by the Defendants, but were obliged to exercise due diligence in determining the reason for the cessation of production: *Soper v Southcott* (1998), 39 OR (3d) 737 at para 21. How long that reasonable diligence would take is not clear, but it is noteworthy that it took only months after Mr. Oneil contacted counsel and then FSI before he entered into an agreement with FSI to bring an action. Even if some knowledge of the reason for the cessation for production was necessary for the Plaintiffs to bring their claims, such knowledge could reasonably have been obtained within a year.

[201] It is interesting that the Plaintiffs suggest that the limitation period actually commenced to run in December 2003 when Mr. Oneil met with counsel, although there is no evidence that, at that time, counsel was aware of or could supply any new information as to the reasons for the cessation of production, other than the fact that it had occurred. Rather, Mr. Oneil's evidence

was that his counsel had merely suggested that extended periods of non-production might have caused the lease to terminate. While Mr. Oneil or his predecessors in interest in 1995 may not have been aware of the provisions of the leases to that effect, discoverability refers to facts, not law, and ignorance of the law does not postpone a limitation period: *Laasch v Turenne*, 2012 ABCA 32, 522 AR 168 at para 24.

[202] In the circumstances, the remaining freeholder Plaintiffs ought to have known that they had claims for the injuries of unjust enrichment, trespass and conversion by mid-1996 at the latest, but the action was not brought until August 2005, roughly nine years later.

[203] The remaining freeholder Plaintiffs have failed to satisfy their onus of proving that they brought their action for unjust enrichment, trespass and conversion within two years of when they ought to have known that the injury for which they seek these remedial orders had occurred. There is no evidence that they exercised reasonable diligence in discovering their injury, or any diligence at all until Mr. Oneil consulted counsel in December, 2003, when he was unhappy with some of the lessees over an entirely different issue.

[204] While mere suspicion that one has a claim may not be sufficient to trigger the running of a limitation period, and situations where the claimant did not have the material facts to support a suspicion have not resulted in the imposition of a limitations defence, the remaining freeholder Plaintiffs had all the necessary information they needed to consider their claim prior to 2003.

[205] The Plaintiffs submit that when they questioned the validity of the leases in December, 2003, Nexen responded that the leases were still valid. That, however, was long after the cessation of production in 1995, and cannot constitute any kind of fraudulent concealment, nor did the Plaintiffs rely upon this or upon any similar kind of representation.

[206] It makes no difference in this case that the issue of whether a delay rental payment could save an otherwise expired lease was not ultimately settled in Alberta until the decision of the Court of Appeal in *Freyberg v Fletcher Challenge Oil and Gas Inc*, 2005 ABCA 46, 363 AR 35, which was issued on February 10, 2005 ("*Freyberg* Liability Decision"). The Plaintiffs have adduced no evidence that they failed to bring their claims on the basis of a mistake of law with respect to the effect of the payment of delay rentals. A mistake of law or uncertainty over the law does not provide a sufficient excuse for failure to bring an action in any event: *Laasch* at para 24.

[207] While there may be an issue whether the cause of action arose or accrued at the beginning of the shut-in period in July 1995, or 90 days later when the leases would have provided for their termination, or at the end of the shut-in period in January 2001, it makes no difference to the limitations issue in this case, as the Statement of Claim was not filed until August 9, 2005, more than two years after the end of the shut-in period. However, following the general rule, the injury likely arose or accrued upon the cessation of production for more than 90 days, which, without reliance on the Third Proviso, would have terminated the leases: *Meek* at para 41.

[208] The Plaintiffs submit the *Limitations Act* precludes the Defendants from relying on limitations defence in that the Plaintiffs brought their action within two years of knowing that the injury "warant[ed] bringing a proceeding": section 3(1)(a)(iii).

[209] The question of when an injury warrants bringing a proceeding is to be approached in accordance with the test set out by the Supreme Court of Canada in *Novak v Bond*, [1999] 1 SCR 808, which was endorsed by the Alberta Court of Appeal in *N(J) v Kozens*, 2004 ABCA 394, 361 AR 177 at para 14, and more recently in *Laasch* at para 19.

[210] The wording of the British Columbia statute under consideration in *Novak* was different from section 3(1)(iii) of the *Limitations Act*, but the critical time in issue is when:

> . . . a reasonable person would consider that someone in the plaintiff's position, acting reasonably in light of his or her own circumstances and interests, *could* not necessarily *should* bring an action. This approach is neither purely subjective nor purely objective. The question becomes: "in light of his or her own circumstances and interests, at what point could the plaintiff reasonably have brought an action"?: *Novak* at para 81.

[211] Chief Justice McLachlan stressed that a reasonable person would think that the plaintiff could not have brought an action at the time the right to do so first arose only if the plaintiff's own interests were "serious, significant, and compelling", and that "purely tactical considerations have no place in this analysis": *Novak* at para 81.

[212] In *Novak*, she referenced examples of when a claimant may have good reason not to bring an action immediately: para 85. None of these circumstances are present in this case. The freeholder Plaintiffs have adduced no evidence of why, in light of their circumstances and interests or those of their predecessors in interest, they could not have brought an action sooner than they did, let alone evidence of "serious, significant and compelling" circumstances. They bear the onus of establishing such circumstances.

[213] The Defendants submit that 108 is also barred from pursuing any claims it has for injuries that occurred prior to January 28, 2007 because it was aware, through its relationship to the top lease principals and FSI, of the section 3(1)(a) factors from early 2004, but did not become a plaintiff in the action until January 28, 2009, more than five years later.

[214] Later in these Reasons for Judgment, I find that 108 has no claim for damages. However, in the event I am wrong in that determination, I have considered whether 108's claims, to the extent they exist, are barred by limitations issues.

[215] 108 submits that, to the extent it has independent claims, these claims fall within section 6(3) of the *Limitations Act*. Since it filed caveats against titles to the Section 25 Lands in respect of the top leases, it submits that it seeks compensation and damages for the loss or delay in being able to take possession and produce leased substances from the Section 25 Lands.

[216] Section 6(1) of the *Limitations Act* states that when a claim is added to a proceeding, the defendants are not entitled to immunity from liability if certain requirements are satisfied. The requirements relevant to 108 are set out in section 6(3), which stipulates that if the added claim adds a claimant:

a) the added claim must be "related to the conduct, transaction or events described in the original pleading in the proceedings";

b) the defendants must have received sufficient knowledge of the added claim within the application limitation period such that the defendants will not be prejudiced in maintaining a defence on the merits; and

c) the Court must be satisfied that the added claim is "necessary or desireable to ensure the effective enforcement" of the original claims.

[217] 108 has the burden of proving (a) and (c), and the Defendants have the burden of proving that (b) was not satisfied.

[218] While the added claim as self-described by 108 may meet the requirements of (a), and (b), as the Defendants do not deny that they had knowledge of the top leases within the requisite two-year period, I am not satisfied that the added claim is necessary or desireable to ensure the effective enforcement of the freeholder lessor's original claims. The claim of 108, to the extent that it exists, is *independent* and accrues to 108 and not the freeholder lessors. While adding 108 to the litigation may serve to support the freeholder lessors' claims to greater damages, that is not the "effective enforcement" of the original claims of unjust enrichment, conversion and trespass.

d. Collateral Issues and the Ultimate Limitation Period

[219] The 10-year ultimate limitation period is relevant in this action only with respect to the Plaintiffs' allegations of historical discriminatory production practices and failure to drill in the Elkton zone. The Defendants submit, and I agree, that any claims arising from these allegations are barred by the ultimate limitation period. The Plaintiffs, however, say that they are not seeking remedial orders with respect to these allegations, but that the evidence with respect to them is relevant to the measure of damages. Given that, to the extent that this evidence is relevant, it will be referenced under that heading.

D. Preliminary Issue 4: Are some claims barred, in whole or in part, by the doctrines of estoppel, laches, or acquiescence?

[220] Coastal and Bonavista submit that the Jerome Group Plaintiffs are prevented from alleging that the assignments are invalid in any way by reason of the application of principles of estoppel, laches and acquiescence. Given the decision I have made with respect to whether the Jerome Group Plaintiffs have established that they are the proper parties to seek a declaration on the status of the leases, I do not have to address this issue with respect to the Jerome Group.

[221] However, in the event I am in error in finding that the remaining Plaintiffs are barred from bringing their damages claims by the *Limitations Act*, I will address the issues of estoppel, laches and acquiescence with respect to these Plaintiffs, and also with respect to the claims for declarations that the leases have terminated.

[222] Given that the freeholder Plaintiffs were not actually aware of the possibility that the leases had terminated prior to FSI's involvement (which is a different question from whether they knew or ought to have known the "injury" for which they were seeking a remedial order had occurred), they did not have the requisite knowledge prior to that time to establish either estoppel or acquiescence: *Freyberg* Liability Decision at paras 127, 130. However, the Defendants submit that acquiescence applies to the Irwin Group Plaintiffs and the Bowen Group Plaintiffs because they continued to receive royalty payments after entering into the top-leases.

[223] There is no evidence that the Bowen Group continued to receive royalty payments after their contact with FSI. I also can find no evidence of laches, in that they acted with reasonable speed to bring the litigation from that point on.

[224] With respect to the Irwin Group, it appears that Mrs. Keam and Mrs. Marshall continued to accept royalty payments from Coastal in 2006, even after they had been named as Plaintiffs in the litigation. However, Mrs. McLaren did not cash royalty cheques after entering into the top-lease agreements until an agreement had been reached among counsel to allow her to do so. I find, however, that given the communications to the Defendants from FSI during this period of time, there was no implication of waiver, and no possibility of detrimental reliance.

[225] I therefore find that the Irwin Group would not be barred from bringing its claims by reason of estoppel, laches or acquiescence.

IV. CORE ISSUE: VALIDITY OF LEASES

A. Facts - Development of Section 25

[226] In this section, I review the evidence of various Defendant witnesses to set out the development of the Section 25 Lands and the 7-25 Well.

a. Nexen Witnesses

[227] At certain periods of time, predecessors to Nexen, being Jefferson Lake, CanQxy and Wascana, were involved in the 7-25 Well, but in this factual narrative, I will refer to all of them as "Nexen" unless the context requires otherwise.

1. Allan Seredynski

[228] Allan Seredynski testified as the corporate officer of Nexen. Mr. Seredynski is Nexen's production engineering manager for Canadian oil and gas, responsible for approximately 3000

wells. His area of responsibility includes Calgary Crossfield, including where the lands that are the subject of this litigation are located. He described his role as being part of the team that ensures that Nexen's interests in the properties it holds are maximized.

[229] Mr. Seredynski described how negotiations among a number of operators with interests and wells in the Calgary Crossfield area led to an agreement to equitably drain reserves and share production from what he referred to as the "Calgary Crossfield Unit", an irregularly shaped area on the eastern side of the City of Calgary that includes Chestemere Lake and the northeast portion of the city, and that extends up the east and west sides of Highway 2 in the Airdrie area. A "unit" is a recognized industry term for a joint venture that attempts to equitably share production from a set block of land. "Unit wells" are wells contained within the boundary of the unit.

[230] Mr. Seredynski described how a gas field was developed near Calgary in the early 1960s, with the result that sour gas or hydrogen sulfide wells were located within the expanding borders of the city. Sour gas wells contain high levels of hydrogen sulfide and carbon dioxide. These elements must be removed from the gas during processing, together with some of the gas liquids, in order to meet pipeline specifications for transport and sale. Sour gas creates safety concerns and requires special handling. At a level of 1% hydrogen sulfide, sour gas is lethal if released. Sour gas from the Crossfield formation has a level between 30-40% hydrogen sulfide, and is thus extremely lethal.

[231] Wells were added to accelerate the drainage of these reserves in order to drain the sour gas wells within the city boundaries in the shortest time possible, with a well density of one well per section. The Petrogas Plant, which is east and slightly north of Calgary and south of Airdrie, came on production in 1961 to process the gas from some of these wells, and continued to operate until it was shut-in at the end of April 2011.

[232] Mr. Seredynski referred to a sour gas gathering system to the east side of Highway 2, north of the Petrogas Plant, which he described as extending north to two wells, the 16-27 and the 10-22, that were drilled in the Crossfield formation in the early 1980s. The production from those wells travelled south to be processed at the Petrogas Plant.

[233] The 7-25 Well is located on the west side of Highway 2, north of Airdrie. North of the 7-25 Well is the boundary to the East Crossfield D1 Unit, which Mr. Seredynski described as being similar to the Calgary Crossfield Unit, as both have wells that traditionally produce from the Crossfield formation. Wells from that unit historically fed into the TAQA East Crossfield Gas Plant (the "TAQA Plant", sometimes referred to as the Amoco Plant), to the north of the 7-25 Well and west of Highway 2.

[234] Mr. Seredynski explained how, when the 7-25 Well was being drilled in 1968, the target formation for the well was the Crossfield formation. As expected, gas was found in the Crossfield formation, but also in the BQ formation, 2000 feet shallower than the Crossfield formation.

[235] The summary report of drilling results for the 7-25 Well created by the on-site geologist based on electronic well log analysis refers to results in the BQ and Crossfield formations, but makes no reference to the Elkton formation.

[236] Mr. Seredynski testified that the joint venture partners wanted to produce the 7-25 Well from the targeted Crossfield zone. As the well was on the west side of Highway 2, the only option was to process the gas through the TAQA Plant to the north, which was then operated by Amoco.

[237] Mr. Seredynski pointed out that in 1968, neither the 16-27 nor the 10-22 well had been drilled, and therefore there was no associated pipeline in the east area of Highway 2 to the Petrogas Plant. The gathering system for the Petrogas Plant at that time terminated some distance to the south of the present location of the 16-27 and 10-22 wells.

[238] Nexen approached Amoco to attempt to include production from the Crossfield formation from the 7-25 Well in the East Crossfield D1 Unit for processing at the TAQA Plant and was rejected. Amoco offered extremely unattractive terms for inclusion of the well in the unit, terms that would leave the joint venture interest holders in the 7-25 Well with a very small fraction of production from the unit.

[239] Nexen had another option, which was to complete the well in the BQ zone. This formation had sweet instead of sour gas requiring less processing, and the working interest holders could run a pipeline north of the well directly to a sales gas line, bypassing the TAQA Plant. A third option was to transport the gas to the Petrogas Plant, but the nearest tie-in at that time was a substantial distance away.

[240] These three options, including the possibility of making an application to the Energy Resources Conservation Board ("ERCB") to have the TAQA Plant designated a common processor so that Amoco would have to accept the Crossfield gas on better terms, were put before the then-working interest owners in the 7-25 Well. They decided to add equipment at the site of the 7-25 Well to do the minimal processing necessary to enable the BQ formation sweet gas to be transported directly to a sales gas line.

[241] Nexen obtained a gas purchase contract from TransCanada Pipelines for the production from the 7-25 Well in November, 1970 and BQ formation gas was produced from the well from 1971 to 1980.

[242] Mr. Seredynski referred to an internal CanOxy document created five years into production of the BQ formation gas that set out what would be necessary to transport Crossfield gas from the 7-25 Well to the Petrogas Plant. This option was not pursued at the time, although the economics appeared to be favourable and Mr. Seredynski could not explain why.

[243] In November 1977, the working interest owners again considered completing and testing the 7-25 Well in the Crossfield formation and applying to the ERCB for common processing status to tie in the well to the TAQA Plant. The correspondence sent to the working interest

owners indicated that the group had made several proposals to Amoco and been rejected on the basis that the TAQA Plant was at its capacity for raw sour gas and that Amoco intended to drill additional wells to load the plant in future years. The then-operator recommended to the working interest owners that they prove the productivity of the Crossfield zone in the 7-25 Well and develop plans for placing it on-stream.

[244] On December 14, 1978, Amoco wrote to CanOxy, which was then the operator of the 7-25 Well, referencing Nexen's request for capacity for production from the well, stating that the plant had no excess capacity to process sour gas, and would not have any for the next seven years. Shortly after that, CanOxy prepared a common processor application to the ERCB. Mr. Seredynski was not sure whether the application actually proceeded, although it appears from correspondence that it was filed with the ERCB in July 1979 and a hearing was scheduled for October 24, 1979. The application indicated that the applicants were of the view that the spacing unit for the 7-25 Well had suffered drainage of approximately 25% of its reserves as of May, 1978. Amoco was informed of the application, with the suggestion that the working interest owners were still willing to negotiate before they proceeded. The capacity issue was resolved through negotiations. Mr. Seredynski testified that he understood that the working interest owners had negotiated a transportation and processing agreement that allowed them access to the TAQA Plant, and the common processing application did not proceed.

[245] On July 4, 1980, the then-operator of the 7-25 Well informed the working interest owners that it wanted to test the Crossfield zone, which involved abandoning the BQ zone and completing the well in the Crossfield zone. Mr. Seredynski confirmed that, while the BQ formation was still producing, the decision to abandon that zone in favour of the Crossfield was made because there was more remaining value in producing the Crossfield than the BQ formation, and also to address the competitive drainage situation. When cross-examined about why the then-operator did not twin the 7-25 Well to produce from both the Crossfield and the BQ formation, Mr. Seredynski indicated that while Nexen did not fully understand the previous operator's analysis, it would have been driven by economics and the price of gas at the time.

[246] The 7-25 Well was put on production from the Crossfield zone in 1981. In preparation, the BQ zone was isolated and cemented and new production equipment was run to the lower Crossfield depth. An agreement dated November 1, 1980 was put in place between the well owners and the TAQA Plant operator relating to the processing of the Crossfield sour gas at the plant.

[247] The 7-25 Well produced from the Crossfield/Wabamun zone from March 1981 to July 1995. The production history for the well indicates some periods of no or zero production throughout those years. Mr. Seredynski testified that some of those periods would correlate to late spring and summer months when the market for gas was limited and TransCanada, the gas purchaser, would have provided a "nil nomination" for production from the well for those months.

[248] Mr. Seredynski explained that it is TransCanada who decides when it needs gas to supply to customers, and provides the well owners with requests, known as "nominations", for delivery

or non-delivery of gas from a well. When there is a nil nomination, the plant operator (Amoco in these years) shuts the well in. Sometimes, the well operator would use shut in periods of nil nomination for maintenance work or pressure surveys on the well.

[249] In 1982, however, the 7-25 Well operator complained to TransCanada about its reduction of the maximum daily quantity allowed to be produced under the gas purchase contract, stating that the productive capacity of the well was significantly greater than that allowed and that it was concerned about drainage of the reservoir by Amoco.

[250] Mr. Seredynski described how Amoco had drilled the 7-34 well and the 16-27 well north east of the 7-25 Well in 1981 and 1982. He noted that it was "well-recognized" that the owners of the 7-25 Well were in a competitive drainage situation with Amoco. He testified that, as a result of the drilling of the 7-34 and the 16-27 wells, the working interest owners in the 7-25 Well decided to drill the 10-22 well to the southeast of the 7-25 Well in order to give them "some . . . straws in the D1 reservoir to be able to extract our reserves".

[251] Mr. Seredynski described how the wells on the east side of Highway 2, including the new 16-27 and 10-22 wells, all produced to a large area-wide gas purchase contract with TransCanada, rather than the well-specific contract that covered the 7-25 Well. There were about one hundred wells on the east side of the highway and in the area to the south around the Petrogas Plant that fed into the plant. Because of the expansion of the City of Calgary in the north and east near that area, it was recognized that the reserves had to be depleted expeditiously. Thus, these wells were allowed to flow year-long without periods of nil nomination. In addition, it was easier for TransCanada to shut in production from the 7-25 Well than to shut in production from the wells covered by the area-wide sales agreement, given their number and the impact on the Petrogas Plant.

[252] Mr. Seredynski conceded that there was more production from the 16-27 and 10-22 wells from 1982 onwards than there was from the 7-25 Well. He also testified that the 7-25 Well experienced depletion during the period of ten years that the well owners were shut out of the TAQA Plant by Amoco, when Amoco's off-setting wells were able to drain reserves.

[253] By the time the 16-27 and 10-22 wells came on stream, the pressure in the 7-25 Well was diminished and the 16-27 and 10-22 wells were accessing parts of the reservoir that had not yet been depleted. He described these wells as being "younger in their life cycle", with higher deliverability.

[254] Mr. Seredynski noted that the transportation and processing fees that were being paid by the 7-25 Well owners at the TAQA Plant were higher, as they didn't have an interest in the plant, compared to the fees paid for the wells on the east side of the highway at the Petrogas Plant. He noted that the deregulation of the gas industry that occurred in the late 1980s would not have changed anything for the 7-25 Well, since gas produced from the well was under contract to TransCanada, and the operator had no opportunity to sell it into the spot market.

[255] Mr. Seredynski testified about a summation of activities relating to the 7-25 Well that had been prepared by a well site consultant during the period of May 4, 1978 to May 13, 1978. This document indicates that the amount of shrinkage or loss of volume of produced gas from the well due to removal of carbon dioxide was 10.66% of the raw volume produced, and that hydrogen sulfide that had to be removed during processing was 41.21% of the raw volume, together with relatively lower but still material volumes of gas liquids. Thus, the shrinkage from raw gas produced from the 7-25 Well to sales gas after the hydrogen sulfide, carbon dioxide and gas liquids had been removed was about 65%, leaving 35% of the original volume produced.

[256] Events involving the 7-25 Well between 1981 and 1988 are described later in these Reasons for Judgment through the evidence of Ronald Watson.

[257] Mr. Seredynski became personally involved with the 7-25 Well in 1988 or 1989, when it fell within his portfolio of properties. At that time, the 7-25 Well was producing from the Crossfield zone and being processed through the TAQA Plant. He was responsible for providing a budget for the well for production and operating costs and for maximizing the volume of gas produced to the gas purchase contract. He was in contact with Amoco who was the contract operator of the 7-25 Well (although Nexen at that point was the operator of record).

[258] To get up to speed, he reviewed the well file. He found that the 7-25 Well had been a challenging well through its life in terms of putting it on production. His perception from the file was that it was an uphill battle with Amoco, although in his opinion Nexen was doing its best to maximize production from the well.

[259] Mr. Seredynski described how the well was "in Amoco's backyard", as Amoco was the contract operator for practical reasons and also controlled the pipeline system from the well to the TAQA Plant. He acknowledged that the well owners had to rely on Amoco to a certain extent and that communications could have been improved. He referred to the fact that, as the well owners were not owners in the plant, they could be shut-out when there were restrictions in capacity or problems with the gathering system.

[260] In 1988, in an attempt to increase production from the 7-25 Well, Mr. Seredynski sent a memo to a company reservoir engineer for the Crossfield area asking if the well would meet Nexen's stimulation criteria. It did not, as the flow rate of the well was so low that even if the result had been a typical re-stimulation increase of 100%, the increased rate of flow would not pay out the cost of the stimulation.

[261] Mr. Seredynski testified that in the late 1980s and early 1990s, TransCanada was aware that the well was only capable of delivering a relatively small volume of gas, so it allowed the well owners to flow the well year-round to sell as much gas as the well could produce. However, at that point, there was not much deliverability left in the 7-25 Well. Mr. Seredynski described the situation as trying to make the best of it; of keeping costs down but at the same time keeping the well on production as much as possible. He described how in the 1990s, gas prices were decreasing, and by 1994 or 1995 were very low.

[262] Mr. Seredynski described the issue of sulphur as a by-product from the 7-25 Well during processing at the TAQA Plant. Sulphur was produced as a liquid, and sulphur prices were also very low during these years. The sulphur had to be dealt with as a by-product, but facilities to produce it in solid form were not available at the plant. He noted that there is a limited market for liquid sulphur, as it cannot be exported out of North America. To be sold, liquid sulphur has to be shipped to certain markets, incurring transportation costs. At the time in question, it was a negative cost to either transport or stock-pile sulphur. This continued through to 1995. The sulphur produced from the 7-25 Well was formed in blocks and stock-piled and was eventually sold in the mid to late 2000s.

[263] In February 1993, on the basis of a deliverability test performed on the 7-25 Well in December 1992, the maximum daily contract quantity under the gas sales contract was reduced, reflecting the fact that the well's deliverability was so low that TransCanada could take whatever gas was produced from the well on a year-round basis. An internal memo from Mr. Seredynski indicated that the operator of the well had no plans to increase deliverability. Mr. Seredynski explained that this was because it was near the end of the well's life, that reservoir pressure was quite low and that the cost of stimulation was about $200,000. In his view, after stimulation or workover, there would not be enough positive cash flow to repay the cost of the workover.

[264] Mr. Seredynski commented on the option of connecting the 7-25 Well to the Petrogas Plant. He indicated that this would require a capital investment in order to build a pipeline underneath Highway 2. He pointed out that there were challenges to doing this with a sour gas well. In his view, there would not have been a significant increase or change in deliverability.

[265] In February 1994, the then remaining well owners had an opportunity to purchase Home Oil's 34.11% working interest in Section 25 where the well was located, pursuant to a right of first refusal that was triggered by a potential sale of that interest to Amoco for $200,000.

[266] Mr. Seredynski's employer at the time had a 12% interest in the 7-25 Well. In evaluating the opportunity, Mr. Seredynski looked at the well's flow rate and asked for an opinion from an in-house petrophysicist from a review of the well logs with respect to whether there were any productive zones other than the BQ and the Crossfield formations left in the well.

[267] Mr. Seredynski also looked at the McDaniels' reserve report, and calculated that his company's cost of further development would be 80 cents per Mcf of gas, which was over the company's target cost of 50 cents per Mcf. He explained that this was a time of very low gas prices and strictly enforced internal targets.

[268] He gave his opinion of why Amoco appeared to be prepared to pay $200,000 for the interest. He pointed out that Amoco controlled the area, controlled the processing facilities for the well and was already the contract operator. It therefore had a much lower operating cost structure.

[269] In June 1994, based on a well deliverability test in November, 1993, the daily contract quantity under the gas purchase contract was reduced again, reflecting reduced volume from the well.

[270] Prior to 1995, Nexen (then CanOxy) had a very small working interest in the TAQA Plant, in the order of .03%. This interest was sold as part of the sale of a number of low-potential, non-operated properties in early 1995.

[271] Mr. Seredynski testified that in 1994 and 1995, the working interest owners were facing a situation where the 7-25 Well was uneconomical. Nexen was reviewing price forecasts for gas that anticipated decreasing prices and its operating cost structure to determine which wells were not covering their variable costs. Early in 1995, the 7-25 Well was "on the knife edge", not generating much cash flow and not losing much, but Nexen was facing lower gas and sulphur prices. By mid-year, the well was losing money in the order of tens of thousands of dollars a month. Mr. Seredynski's department was asked by Nexen management to look at its entire portfolio to see if there were any properties that it made sense to shut-in, that were in a position of negative cash flow.

[272] According to an internal economic evaluation analysis run on July 4, 1995, the 7-25 Well had negative cash flow at all discount rates from 0% to 20% before tax for the years from the remainder of 1995 through the end of 1990, even attributing a value to sulphur that was not realistic.[Mr. Seredynski stated that at that point in time and from forecasts going forward, there was no attributable value to the well, and it was anticipated that the company would be generating negative cash flow if it continued to produce from the 7-25 Well.

[273] Mr. Seredynski sent a memo dated July 11, 1995 to his manager that recommended suspending the well due to its low raw gas production rate and the high field gathering fee charged by Amoco, which he explained resulted in a negative cash flow for 1995 and the well's remaining life of less than five years. The memo indicates that Mr. Seredynski had approached Amoco about the possibility of reducing fees on the well. Mr. Seredynski testified that the response was disappointing, that the small decrease in fees offered would not have had a significant effect on the economics. Because the company had sold its small interest in the TAQA Plant in 1995, it would now have to pay a capital fee for processing that would increase the total fees. However, Mr. Seredynski testified that this would not have made a difference to the decision whether or not to suspend, as even at the lower level of fees available to the plant owner with the small interest that it had held, the well was uneconomical.

[274] The memo concludes as follows:

> CanadianOxy's share of Crossfield sales gas reserves left in the ground would be less than 15 Mmcf. The well was originally a BQ producer before the Crossfield zone was completed in 1981. The small amount of remaining BQ reserves (COPL share: 100mmcf), makes a recompletion uneconomic. Logs have been reviewed by the Area Team and they concur that no uphole potential zones are present and that CanadianOxy's [working interest] should be offered to our partners or Amoco for the abandonment

> liability. The well abandonment, surface reclaimation and pipeline abandonment cost is estimated at $165 M (COPL net: $19.8M).

[275] Mr. Seredynski confirmed that he himself had run the economics for the Crossfield zone referred to in the memo. While he did not prepare a full economic run for the BQ zone, he testified that, based on the small amount of reserves and the fact that it would have taken an additional investment of capital to restore the well to BQ formation production, it was clear that it would not be economical at current gas prices, as it was not economical even without the additional capital outlay.

[276] Mr. Seredynski agreed that, at projected gas prices, he saw no future prospect for profitability in the 7-25 Well for the following five years.

[277] Nexen management agreed with Mr. Seredynski's suggestion that the well be suspended.

[278] Mr. Seredynski disagreed with the suggestion by an expert witness called by the Plaintiffs that there appeared to be a deliberate lack of attention by the operator in draining the 7-25 Well's reserves in favour of two other Nexen wells. He stated that this was wrong; that Nexen was looking at a competitive drainage situation for the Crossfield reserves; and:

> . . . why would we shut-in one of our straws in the reservoir and reduce our ability to compete against other operators in the area such as Amoco who had 50 straws and we had three? Why would we shut one of them in and reduce our drainage of the reserves?

[279] The 7-25 Well was suspended on July 31, 1995. The notification form submitted to the ERCB stated that the reason for the suspension of the well was that is was "uneconomic to produce at this time". Mr. Seredynski confirmed on cross-examination that the 7-25 Well was shut-in because it was uneconomical at the current pricing of the day. He agreed that this was not because there was no market for the gas.

[280] At the time, Nexen (CanOxy) held 12.03% of the working interest in the well, as did ExxonMobil. Amoco held 34.11%, PanCanadian held 1.88%, Esso held 24.06% and Union held 15.99%.

[281] To suspend the well, the operator set in a retrievable tubing plug, pressure-tested it, filled the well with inhibited condensate and chained and locked the wellhead. This would take a day. The steps would have to be reversed to put the well back on production, which would also take a day.

[282] Mr. Seredynski testified that the plan for the well in July 1995 was to suspend it as it was uneconomical, maintain it in Nexen's portfolio of properties, conduct surface inspections as required to ensure that wellsite was safe, and to review within the term if conditions changed in the markets that would make the well economical.

[283] On October 19, 1995, Nexen received a letter from TransCanada that decreased the nominations for maximum daily quantity under the sales contract to zero with effect on August 1, 1995. This letter was found in Nexen's well files. Someone had hand-written "SI Sept.1/95 permanently" on the letter. Mr. Seredynski could not identify who had written this, and indicated it was not consistent with how he had viewed the well at the time, as the intent was not to permanently shut it in, but to suspend it on a temporary basis until pricing and conditions improved. He noted that the TransCanada gas purchase contract that was specific to this single well stayed in effect, although Nexen would have to notify TransCanada if it wished to restore production. By a letter of the same date, TransCanada indicated that it wanted to release any firm transportation capacity associated with the well, making the contract "Non-Delivering" in its files. The letter indicates that if Nexen wished to reactivate deliveries, a written request would be required and would be subject to availability of firm transportation capacity.

[284] Mr. Seredynski confirmed that Nexen did not notify the other working interest owners of the shut-in of the well, as the decision was within its power as operator of the well based on its review of the economics.

[285] He commented that at the time suspension was being considered, Nexen's petrophysicist and geologist would have looked at the well logs to determine if there was evidence of any other producible zone, and the results would have been negative.

[286] On October 10, 1995, Amoco offered to take over the 7-25 Well and assume any abandonment liabilities. Mr. Seredynski recommended the acceptance of the offer, and the situation was communicated to the other working interest owners, but the transfer did not proceed. Mr. Seredynski could not say why.

[287] In December 1995, the contract operator agreement with Amoco for the 7-25 Well was terminated on the basis that the well had been suspended, and Nexen was attempting to sell its interest.

[288] From 1995 to 2000, Mr. Seredynski's main responsibility with respect to the well was to ensure that it was safely secured and to "keep it on our radar" if any conditions changed to make it economical. Lease rental payments were made to the freehold lessors while the well was suspended, and were cashed.

[289] Mr. Seredynski testified that the 10-22 well and the 16-27 well continued on production during the period 1995 to 2000, as they had a different operating cost structure and were economic to produce. He noted that the wells were producing to the Petrogas Plant, where the working interest owners had an interest and were thus assured processing capacity, and that the incremental cost to process the gas from these wells was very small.

[290] An economic analysis of the 16-27 well dated March 1995 relating to the removal of a sulphur plug from the tubing indicated that, despite the plug and the costs of a clean-out, the well was economic to flow. The first clean-out was not successful, but even with the increased costs of a second clean-out, the well was economic.

[291] In 2000, a line heater that had remained on-site at the 7-25 Well was required on another property, and was sold to that other property by the working interest owners of the 7-25 Well. Mr. Seredynski suggested that it would be relatively easy to purchase another heater if it was required, and that, in any event, it was only necessary for production from the Crossfield formation.

[292] In November 2000, Nexen received an independent operations notice with respect to the 7-25 Well from Triquest, with a proposal to abandon the Crossfield zone and re-complete the BQ formation. The proposal was reviewed by various Nexen departments. It involved a small investment by Nexen, about $30,000, so Nexen agreed to participate.

[293] The re-completion, which commenced on January 13, 2001, required isolating the Crossfield zone and increasing the plug, pressure-testing and further plugging and then re-entering the BQ formation through its blocked casing. Triquest performed the abandonment and re-completion. Once production was established from the BQ formation, Nexen resumed its position as operator and the well was tied-in and made ready for production to the TAQA Plant. At this time, Prime West was the operator of the TAQA Plant and the processing fees were less than they had been in 1995. Gas prices in January 2001 were extremely high, approaching $14 per MCF in Mr. Seredynski's recollection, as opposed to about $1 per MCF in 1995. In 2004, Bonavista became operator of the 7-25 Well.

[294] On September 20, 2005, counsel for the Plaintiffs demanded of some of the Defendants, including Nexen, that they immediately cease production from the 7-25 Well.

2. *Ronald Watson*

[295] Ronald Watson testified as a reservoir and exploitation engineer with CanOxy, Nexen's predecessor during the years at issue with respect to the 7-25 Well. Mr. Watson was the supervising engineer for the Crossfield area from 1988 to 1991. Prior to that, in 1984 and 1985, he was a plant engineer at the Petrogas Plant. Mr. Watson was with CanOxy and then Nexen for about eighteen years before leaving the company in 1997, after having served as Nexen's chief reservoir engineer for Canada.

[296] Mr. Watson described how, in his early years as a working engineer and later as a supervising engineer, he was responsible for the "Petrogas area", which he described as including the lands and wells surrounding the Petrogas Plant and the TAQA Plant, from the City of Calgary to and including the East Crossfield Unit to the north. Mr. Watson commented that the Petrogas area was the most important property that CanOxy had at the time. He described how the boundaries of the city were moving closer to CanOxy's wells and pipeline systems, and noted that there was concern that there would be public pressure to shut the Petrogas Plant down. CanOxy considered it important to drill wells and build pipelines so that they could be established with appropriate set-back areas to keep the City from encroaching further in the area.

[297] Mr. Watson recalled that he first became involved with the 7-25 Well in 1981, when a workover was being conducted to try to get production going from the Crossfield zone. This was one of his first well-site operations. He described it as a key well for the company, being high in H_2S and at the edge of the main highway where it could be seen by passers-by. He described how the work-over wasn't going well and was expensive.

[298] Mr. Watson indicated that, at about the same time, Amoco was drilling the 7-34 well, which he described as a great well. The 7-25 Well had proven that the Crossfield zone extended south of the East Crossfield Unit and that there were reserves south of the unit that were being drained. He explained that Amoco operated 20 to 30 unit wells in the East Crossfield Unit, and that the 7-25 Well was the only non-unit well operated by Amoco in the south of the unit.

[299] Mr. Watson testified that periods of non-production for the 7-25 Well between 1981 and 1984 related to seasonal demand for gas, and periods when there was no nomination from TransCanada because of lower demand.

[300] In September 1982, Mr. Watson sent an internal email to the Manager of Engineering recommending that gas from the 7-25 Well should be re-routed to the Petrogas Plant as soon as possible. Mr. Watson explained that the 7-25 Well was capable of producing at least 3 ½ MMcf/d, but that CanOxy was limited by the agreement with Amoco at the TAQA Plant to about 2 MMcf/d. The memo refers to an over-capacity problem at the TAQA Plant and Mr. Watson testified that, at the time, the TAQA Plant was essentially full, with not much capacity for non-unit wells.

[301] The memo pointed out that processing fees would be slightly more advantageous at the Petrogas Plant, and that operating fees of a few thousands of dollars a month could be saved if production from the well was routed there.

[302] Mr. Watson testified that the biggest issue with the 7-25 Well producing to the TAQA Plant was as described in the memo:

> A basic conflict of interest exists in this situation. Amoco has no interest in the south end of the pool . . . but they have wells bordering our lands which have been draining us for the last 14 years. There is no doubt they would prefer to have us shut-in and, therefore, the present arrangement is unacceptable. A reasonable estimate of the drainage to Amoco up to now would be about 30 BCF Raw.

[303] Mr. Watson testified that what he meant by "unacceptable" was that producing the 7-25 Well to the Petrogas Plant would have been a better alternative for CanOxy. He testified that Amoco was not co-operative when CanOxy tried to improve the marketing situation. His job was to maximize reservoir production. He didn't like the situation, and the memo set out certain alternatives. Mr. Watson ran the economics of building a pipeline and re-routing the gas to the Petrogas Plant and they made economic sense.

[304] Mr. Watson explained that there was some concern about running a pipeline across the main highway, but that they had found a way to do that. Management agreed with the recommendation and Mr. Watson wrote to the working interest owners of the well on September 10, 1982 recommending this change. The estimated cost of the approximately one kilometre of pipeline it would take to connect to the then-existing pipeline to the 16-27 well was $180,000. The working interest owners agreed with the proposal.

[305] On December 22, 1982, Mr. Watson wrote to the ERCB applying for a permit for both a fuel gas and sour gas pipeline to tie-in the 7-25 Well to the Petrogas Plant gathering system. He advised the ERCB that an application for approval of a pipeline crossing under the highway had been submitted to Alberta Transportation.

[306] In the permit application, CanOxy referred to Amoco restricting the 7-25 Well's production "because of an alleged lack of processing capacity" at the TAQA Plant.

[307] The ERCB requested further information in a series of letters. Mr. Watson said that there were more questions than normal, which he ascribed to the fact that this project would involve a sour gas pipeline in an urban area. Mr. Watson described issues with landowners and issues the ERCB had with a proliferation of pipelines in the area.

[308] On April 5, 1983, Mr. Watson received a letter from the ERCB indicating that the ERCB had received a number of applications for sour gas facilities in the Crossfield area, including CanOxy's, and that it was considering holding a hearing to allow all applications to be heard contemporaneously. The letter indicated that the application would thus be held in abeyance for period of time to allow operators in the area to submit applications for development of the reserves under their control. Mr. Watson testified that this was a big change, since the letter was from the ERCB's legal department, not from operations. The team at CanOxy knew that the application was no longer routine, and would certainly take longer.

[309] On April 7, 1983, the senior vice-president of engineering sent an internal memo to Mr. Watson's supervisor, copied to him and others, indicating that he had received letters from the ERCB setting out its concerns in the East Crossfield area, and that the ERCB was proposing an omnibus hearing on the area at which a number of applications would be considered. The memo called for a meeting to discuss a strategy, and notes that ". . . it is a very messy situation."

[310] Mr. Watson testified that this was becoming a very big issue for CanOxy, given the encroachment of the City of Calgary close to the Petrogas Plant and gathering system, with increasing public opinion that there should not be development of sour gas so close to the City limits. CanOxy's management was of the opinion that there was a considerable risk to the continued operation of the Petrogas Plant if a hearing was held. The ERCB was expressing concern about whether sour gas production in the location of the plant should be shut-in.

[311] One of the issues discussed at an internal meeting with senior management was whether the pipeline to the Petrogas Plant from the 7-25 Well should go ahead, given that CanOxy would

be forced into a hearing if it continued with the application. It was thought that a likely outcome of such a hearing would be that the Petrogas Plant and its gathering system would be shut-down.

[312] On April 8, 1983, the senior vice-president sent another memo that alerted the group that the ERCB was taking the position that the terms of the existing permit that allowed CanOxy to produce certain wells to the Petrogas Plant were in issue, and that sections 16, 22 and certain lands called the "Irricana lands" were not included in the approval. This was a major problem, as there were wells producing from these lands to the Petrogas Plant. Eventually, the issue was resolved with respect to the section 16, 17 and Irricana lands, but the 7-25 Well, which was definitely outside the previously-approved plant area and could not be added without modification to that approval, remained an issue.

[313] According to an internal memo, the 7-25 Well pipeline application was discussed at a meeting of the group held on about April 18, 1983. The memo indicates that the ERCB would be approached to confirm that the section of land that included the 16-27 well was within the previously-approved area for production to the Petrogas Plant. CanOxy would co-ordinate with Mobil, the operator of the Irricana field, to attempt to ensure that this issue could be handled without a hearing. If these things were accomplished, the 7-25 Well pipeline application would be withdrawn. The memo notes as follows:

> . . . This is supported on four counts. The 16-27 to Petrogas pipeline can be kept full without 7-25; the Prairie Pacific 11-24 well can be used to pressure Amoco to take outside gas as can the Atcor 4-35 well; Section 25 is definitely not in the approved area for Approval 3406, therefore it would be necessary to amend that approval; and bringing additional gas from areas remote from Calgary would be further against our position of attempting to expeditiously deplete reserves close to urban areas . . .
>
> Although it is important to CanadianOxy to produce the Crossfield East reserves, it is important that we do not appear to be acting solely for our own benefit as one of the penalties for acting improperly will be loss of operatorship of the Units and Petrogas. This situation will become more critical should the market situation deteriorate.

[314] Mr. Watson testified that going ahead with the 7-25 Well application would have triggered an ERCB hearing that would jeopardize the entire Petrogas Plant. This was the primary concern. The Petrogas Plan was owned by a number of other well owners. CanOxy was operator of the plant and could not be seen to be acting solely for its own benefit, or it would lose its position as plant operator. On cross-examination, Mr. Watson conceded that CanOxy had "sacrificed" the option of the 7-25 Well producing to the Petrogas Plant to secure a bigger corporate objective of making sure the Petrogas Plant was not the subject of an ERCB hearing, and that the other reasons listed in the memo were secondary justifications.

[315] By letter dated May 10, 1983, the ERCB agreed that the 16-27 well and the 10-22 well were included in the previously-approved Petrogas Plant area and that producing these wells to the Petrogas Plant would not require a formal application. It noted that "(p)rocessing of gas from

the [7-25 Well] [at the Petrogas Plant] may not proceed unless application is made to the Board to amend [the approval]."

[316] By memo dated August 16, 1982, Mr. Watson recommended that CanOxy drill the 10-22 Well, as Amoco was draining reserves at the south end of the unit with its 7-34 and 10-36 well. The memo recommending this indicates that in Mr. Watson's view, "a third well to complement the 16-27 well and [the 7-25 Well] will help to decrease this loss."

[317] Mr. Watson testified that there was a significant volume of non-unit gas south of the East Crossfield unit, and "we needed to increase the uptake from the non-unit area for everyone's benefit". However, Mr. Watson was asked by the ERCB to justify why CanOxy needed to drill the 10-22 well, which was not a normal requirement from the ERCB in his view.

[318] In 1987, when he was more senior with the company, Mr. Watson talked to the marketing department to see if CanOxy could improve nominations for the 7-25 Well, as it was still being shut-in from time to time based on nominations and gas marketing restraints. Mr. Watson addressed a reference in a 1987 memo indicating some discussion that the TransCanada contract for the 7-25 Well may be amalgamated with the TransCanada gas purchase contract for gas from the Petrogas Plant, or that the 7-25 Well may be tied in to the Petrogas Plant. He explained that, at the time, there was no longer a significant capacity issue at the TAQA Plant, but there were still marketing constraints on the 7-25 Well. One way to get around those restraints would be to include the 7-25 Well in the TransCanada contract for the Petrogas Plant, which did not have the normal marketing constraints of other contracts, as the ERCB was allowing the reserves processed at that plant to be produced as quickly as possible. Another alternative was to have the well produce to the Petrogas Plant. Neither strategy came to pass. Mr. Watson testified that CanOxy decided that it would continue to try to see whether it could get the 7-25 Well production processed through the Petrogas Plant.

[319] Mr. Watson testified about stimulations that had been performed on the 7-25 Well, the 10-22 well and the 16-27 well. He testified that they were all comparable, large "acid jobs", all successful and all gave good results and that there was not much difference between them. He noted that the 7-25 Well was similar in its producing capabilities to the 10-22 well and the 16-27 well, but that it produced less because of marketing and plant capacity constraints. He also testified that the 7-25 Well's location in the reservoir was a factor, that the 10-22 well which was farther south had an effective drainage area of two sections, while the 7-25 Well had an effective drainage areas of half a square mile. The 16-27 well was also drilled on the edge of the reservoir and had roughly the same drainage area as the 7-25 Well. Mr. Watson noted that, since the 10-22 well had about a four times larger drainage area, it produced a lot more gas than the other two wells.

[320] Mr. Watson was asked why another stimulation had not been performed on the 7-25 Well after the 1978 simulation. He said that the initial stimulation was very effective, allowing the well to be capable of about 3 ½ MMcf/d, which was reasonable for the well. The 7-25 Well had mechanical issues in that, given that it had drill hole perforations in the BQ zone, it could not

receive the same type of foamed "acid job" that the others had. The marketing constraints also made it unlikely that another stimulation would have been worth-while.

[321] Mr. Watson strongly disagreed with the suggestion that there was a deliberate lack of attention paid to the 7-25 Well by CanOxy and Nexen. He testified that he was very familiar with the well and had spent a great deal of time trying to improve production from it. He did not like what Amoco was doing competitively, including its failure to cooperate with respect to plant access and processing fees, but had come to realize that this was what the business was like. While he was unhappy with the outcome, he made a good effort to get the well optimized and looked at the alternatives.

[322] Mr. Watson described the biggest constraint to production at the 7-25 Well being the marketing constraints, which did not involve Amoco, and the plant capacity issues, which did. He conceded that if the 7-25 Well had been producing to the Petrogas Plant, it would have been producing continuously.

[323] Mr. Watson was also asked why CanOxy had not brought a common processor application in relation to the TAQA Plant to the ERCB in 1983 when it was having problems with Amoco. He said that CanOxy's view was that, as the Amoco plant was full, such an application would not be successful.

b. ExxonMobil Witnesses

1. Jeffrey Lim

[324] Jeffrey Lim is a professional engineer and the joint interest advisor and representative for ExxonMobil and Imperial Oil. In June, 2000, he was a reservoir engineer with ExxonMobil and was asked to perform a technical evaluation of the 7-25 Well in connection with the proposed sale by Canadian 88 of certain working interests it held to Triquest, including the 7-25 Well. Canadian 88 had requested that ExxonMobil waive its right of first refusal in order to allow the sale to proceed. Mr. Lim recommended the waiver as the economic results of his evaluation indicated to him that ExxonMobil should not exercise its right of first refusal. In his recommendation to the land department, Mr. Lim indicted that the offer was "below our corporate rates".

[325] In October 2000, Mr. Lim evaluated an offer from Triquest to ExxonMobil to purchase ExxonMobil's interest in the 7-25 Well for $14,000. Mr. Lim advised against acceptance of that offer on the basis of economics.

[326] In November 2000, ExxonMobil received an Independent Operator Notice from Triquest with respect to a rework of the 7-25 Well, indicating that the authority for expenditure for the work would be roughly $309,5000. ExxonMobil agreed to participate, in part based on Mr. Lim's technical and economic evaluation.

2. Randy Thomsen

[327] Randy Thomsen is a senior landman with ExxonMobil and Imperial Oil. In the summer of 2000, when he was a member of the land administration department reviewing contracts, he was asked to check the contract file with respect to the 7-25 Well, as a waiver of right of first refusal request had been received from Canadian 88. He checked the file to ensure that the parties and interests were correct and that ExxonMobil did in fact have a right of first refusal. As part of his review, Mr. Thomsen checked the Jefferson SW/4 Lease and production from the 7-25 Well from a computer application called AccuMap.

[328] Mr. Thomsen testified that he noticed that the well had not produced for five and half years and looked at the terms of the lease. He testified that, since the well had not produced and "it had been shut-in and producing at a pretty high rate, [he] was concerned that perhaps we had a problem with our lease". Mr. Thomsen testified that his information from AccuMap was that the well had produced at a rate of 500 MCF per day, and "without the benefit of knowing any more about the well", he assumed that this was a good rate of production and that it should be economic to produce the well. He expressed doubt about whether the lease was still valid, but suggested that a lawyer look at it.

[329] Mr. Thomsen put his thoughts in a memo to the area landman, Shannon Jackson, and others. He had no further dealings with the right of first refusal.

[330] In November 2000, Mr. Thomsen was in the position of negotiating landman, and had requested a technical evaluation of the 7-25 Well from Mr. Lim and a geologist in order to determine whether ExxonMobil should participate in the Triquest rework of the well. Mr. Thomsen generated a form dated December 4, 2000 to provide the technical people with some background information about the property. In the commentary section of the form, he inserted the following note: "[a]s the well had been shut-in since 1995, there is a possibility that the freehold leases have terminated for lack of production. If [ExxonMobil] elects to participate, seek Law's opinion re: leases. New leases may be required."

[331] Mr. Thomsen testified that he wanted to highlight that there may be an issue with the lease. He raised this concern with a joint venture representative for the company, Eco Aukema, who retired in 2005, and Mr. Aukema said he would look into the reason why the well had not produced. Mr. Aukema later advised Mr.Thomsen that the well had been shut-in due to high fees that would make the well uneconomic. Mr. Thomsen testified that this allayed his concerns in part but left a "slight cloud" in his mind about whether shutting in a well for economic reasons would keep a lease in effect, as there was no case law that he was aware of on the issue. He pointed out that he did not have the capacity to make a determination on whether the lease had died.

[332] After receiving an independent operations notice from Triquest, Mr. Thomsen phoned James Morrice, a landman at Triquest, to talk about certain issues relating to the proposed rework. From his notes of the conversation, Mr. Thomsen recalled that he advised Mr. Morrice of his concern about the validity of the leases, given that the well had been shut-in. He suggested that if the leases were not still valid, new ones may be required, and thought that Mr. Morrice

was going to examine his leases and make his own conclusions. He did not recall hearing from Mr. Morrice again.

[333] Mr. Thomsen testified that when he conveyed the executed authorization for expenditure for the Triquest well rework and advice to Triquest that ExxonMobil had elected to participate, he was comfortable with participating as he was of the opinion that the lease was in good standing.

c. Bonavista Witnesses

1. James Morrice

[334] James Morrice was the vice-president, land of Triquest in the late 1990s when Triquest decided to rework the 7-25 Well. The well had come to Triquest as part of a package of interests from Canadian 88, and Mr. Morrice reviewed the Canadian 88 land files to ensure that Triquest had acquired an interest in the well before the independent operations notice to recomplete the well was issued in November, 2000.

[335] Mr. Morrice recalled that he had had conversations with Mr. Thomsen around that time, but did not recall Mr. Thomsen expressing any concerns about the validity of the leases. He testified that he did not have any concerns about whether the cessation of production would affect the leases, as he knew from his prior experience the difficulties encountered in getting production from sour gas wells into gas plants. He commented that times were different then, that Amoco was reluctant to let other people into their plants and it was not unusual to see shut-in wells for that reason. He testified that he had checked to ensure that shut-in royalties had been paid.

[336] Triquest was subsequently sold to Bonavista in 2003 and Mr. Morrice stayed on as a consultant, primarily to sign assignments and transfers as part of the transition process. Mr. Morrice said that he had no concerns about the lease validity of the 7-25 Well and no discussions with anyone at Bonavista about it.

2. Cory Stewart

[337] Cory Stewart is the Manager, Land of Bonavista, and has been since February 2010. The previous land manager retired in 2011. Mr. Stewart reviewed the Bonavista land files for the purpose of this litigation, including the Scurry NE/4 Lease and the Scurry SE/4 Lease.

[338] Mr. Stewart was referred to a letter addressed to Union Oil from Mr. G. dated June 17, 1977, which advised that Merville Stewart had disposed of his interest in the royalty relating to the Scurry leases, but was unable to locate his documentation. Mr. G. requests copies so the necessary transfer could be made to "the purchaser, Snell Farms Ltd.". He testified from his review of the files that Bonavista and the predecessor companies to Bonavista acted upon this letter and subsequent letters on the file, and directed all future correspondence, notices,

payments and royalties to the assignees mentioned in the letters, first Snell Farms and then later Wheatland. Cory Stewart said that there was no indication in the records that Merville Stewart had ever contacted any of the predecessor companies with complaints about royalty payments, or that Snell Farms had contacted them with concerns over royalty payments.

[339] Cory Stewart testified that while he could find no record of any payments to Snell Farms in his records, payments had been made to Merville Stewart until 1969 , and that the next payment he could find referenced on the files was a payment to Wheatland in December 1989. Cory Stewart confirmed that Bonavista had no information with respect to why the 7-25 Well was shut-in from 1995 to 2001, other than what it had learned from Nexen.

3. Wesley Owen

[340] Wesley Owen is the controller of Bonavista, overseeing operational accounting. He testified that from 2001 to 2011, Bonavista (or Triquest for the years 2001 to 2003) paid royalties on the NE/4 of Section 25 to Wheatland in the amount of $687,277. The amount of royalties paid by Triquest in the years 2001 to 2003 were estimated by Mr. Owen. Between 2001 and 2011, Bonavista (and Triquest) paid royalties on the SE/4 of Section 25 to Computershare Trust Company in the amount of $927,899. Computershare administers the gross royalty trust over the SE/4 and the parties are in agreement that Wheatland owned a number of those units and received most of the gross royalty trust payments.

d. Coastal Witness

1. Rahim Lakhoo

[341] Rahim Lakhoo is the president and vice-president, land of Coastal, a small privately owned oil and gas company. In 1993, Coastal purchased a package of land from Unocal that included a 100% working interest in the Union NE/4 Lease, and a 50% working interest in the Scurry NE/4 Lease. Coastal did not have any concerns about the validity of these leases until the litigation commenced. Coastal inherited files and an electronic database with respect to the leases and other lands from Unocal.

[342] Mr. Lakhoo testified that Coastal had advised the Irwin Group that Coastal had acquired the Union NE/4 Lease from Unocal, and that it continued to pay them royalties. With respect to the Scurry NE/4 Lease, Coastal continued to pay Wheatland royalties, consistent with the assignment of the Stewart lease to Snell Farms and the direction to pay from Snell Farms to Wheatland that it found on file. A copy of the assignments from Merville Stewart to Snell Farms were found in Coastal's files from Unocal, together with Mr. G.'s July 25, 1977 letter to Union Oil, the predecessor company to Unocal. This letter indicates that Mr. Stewart has transferred his interest in the Scurry NE/4 Lease and the Scurry SE/4 Lease, but has misplaced his documentation, and asks for copies so the necessary transfer can be arranged. It informs Union Oil that Snell Farms is the new depository.

[343] The file also contained a copy of a letter dated June 17, 1982 from Mr. G. to Union Oil entitled "Snell Farms Ltd. - Sale of Royalty Interest to Wheatland Farming Co. Ltd.", and indicating that it gave authority to change the royalty interests of Snell Farms to Wheatland.

[344] Also on file are letters dated July 20, 1983 and July 25, 1983 from lawyers with MacKimmie Matthews acknowledging royalty payments for the 7-25 Well, and giving instructions with respect to future payments.

[345] Mr. Lakhoo testified that Coastal had never had a problem with Wheatland since it acquired the leases in 1993, that Wheatland has been paid all the shut-in royalties and all producing royalties and there had never been a complaint or objection. He also testified that there have not been any concerns raised by Snell Farms.

[346] Coastal has not been involved in any of the operations in relation to the Section 25 Lands or the 7-25 Well. In March 1997, Coastal was contacted with respect to a right of first refusal it held on the prospective sale of Section 25 Lands from PanCanadian to Panwest, and it waived its rights. Again, with respect to the June 28, 2000 sale from Canadian 88 to Triquest, Coastal declined to exercise its right of first refusal. Coastal elected to participate in the Triquest rework of the well.

B. Expert Witnesses

[347] The Plaintiffs called expert evidence on three issues:

(a) the extent of the Elkton formation under the Section 25 Lands and the volume of Elkton gas available to be produced had a well been drilled in that formation;

(b) whether the operator of the 7-25 Well sought to maximize production through the prudent application of standard oil and gas engineering practices;

(c) whether there was any point in time between 1995 and 2001 when it was economic to produce the Crossfield zone or the BQ zone from the 7-25 Well.

[348] The Defendants called rebuttal evidence on these issues.

[349] The Plaintiffs also called a witness to give expert testimony on the issue of whether there was a market in natural gas between 1995 and 2001.

[350] Given the comments of the Alberta Court of Appeal in the *Freyberg* Liability Decision, I must address the question of whether expert evidence is necessary in this case.

[351] At para 87 of the *Freyberg* Liability Decision, Ritter, J.A. concluded that the lay evidence in that case provided a sufficient factual basis for a court to decide upon the existence of an economical and profitable market. The Court of Appeal found that there was evidence that

the lessees foresaw profitability at the relevant time, and noted that this was practically conclusive of the issue: para 73.

[352] In this case, the lay evidence of the Defendants is to the effect that the 7-25 Well was shut-in because it was uneconomical to continue production in July 1995. The expert evidence adduced by the Defendants focuses on a slightly more objective issue: whether the decision to shut-in the well was appropriate, and whether a prudent lessee would have foreseen profitability during the shut-in period. The Plaintiffs adduced expert evidence to counter this opinion, and also to address other issues that they suggest are relevant to the assessment of damages.

[353] I find that, in the circumstances of this case, the expert evidence is relevant and necessary.

a. Ross A. Clark

[354] Ross A. Clark was called to give expert evidence on behalf of the Plaintiffs with respect to a report issued jointly with Paul V. Pedersen, P Eng. on the issue of the extent of the Elkton formation under Section 25.

[355] Mr. Clark is a reservoir geologist with many year of experience who is currently the Executive Vice-President and a director of Kallisto Energy Corp. Mr. Lore, who is interested in this litigation as a principal of FSI, is the President and CEO of Kallisto. Mr. Clark has worked with and for Mr. Lore in various companies for the last fifteen years.

[356] Mr. Clark is not licenced as a professional geologist in Alberta, and is not entitled to use the designation P. Geol. However, I qualified Mr. Clark as an expert entitled to give opinion evidence in the area of reservoir geology arising from his years of experience, despite his lack of professional designation.

[357] In 2009, CrossAlta brought an application before the ERCB to shut-in the 7-25 Well for "production performance issues". Mr. Clark was asked at that time (it is not clear in what capacity) to evaluate the reserves and geology of the 7-25 Well.

[358] In January 2012, Kallisto applied for a licence to drill a well in Section 26 in an area west of the 7-25 Well (the "11-26 Well"). CrossAlta objected, and the ERCB held a hearing to determine whether a licence would be granted. Mr. Clark testified at that hearing as part of Kallisto's team of representatives about the geology of the Lower Manville information, including some aspects of the Elkton formation.

[359] Mr. Clark was asked by the Plaintiffs in this litigation to calculate potential recoverable natural gas reserves in the Elkton formation for Section 26 and 26 by mapping the Elkton pool. He based his opinion on a porosity thickness map he constructed by integrating a 3-D seismic map of the Elkton that CrossAlta had filed with the ERCB in the course of the 2009 proceedings. In doing so, he also reviewed the well logs and some core data from three existing wells.

[360] The CrossAlta map was marked as an exhibit in these proceedings by consent, with the Defendants reserving the right to address the issue of the weight that it should be given.

[361] Mr. Clark was not personally involved in the preparation of the CrossAlta map, which does not on its face identify itself as a 3-D seismic map, although that is how Mr. Clark characterized it. He testified that the map had been filed as part of CrossAlta's original application to the ERCB in 2008 by a person named Patrick Collins, who was part of the CrossAlta team. He had not sought Mr. Collins'consent to use the map as he did. The legend on the map is not entirely legible, and the entirety of the report or submission to which it was attached was not produced. Neither was the seismic data that may have supported the map.

[362] Mr. Clark testified that the source data for the map was a 3-D geophysical survey that had been shot in 2000 to which CrossAlta had access. He said that he reviewed that source data and compared it to his own mapping, finding only "small interpretive differences".

[363] Mr. Clark used the map to outline the outside area of the Elkton formation. He considered this outside line to be "zero thickness" and then filled in some interior contour lines. He calculated porosity from well logs, and multiplied porosity by thickness to calculate porosity feet. He conceded that there were only two wells that had actually penetrated the Elkton, in close proximity to each other in Section 36 to the north of Section 25 and the 7-25 Well.

[364] From his mapping, Mr. Clark suggested that there is 11.3 BCF of Elkton gas in Section 25.

[365] Mr. Clark also testified that he had seen a map that was part of a 1972 ERCB decision on whether concurrent production of oil and gas should be allowed in the area. He testified that the map appeared to show that the Elkton formation extended approximately 100 acres into the north of Section 25, a smaller area than delineated by Mr. Clark in his opinion in this litigation. This map showed no Elkton gas in Section 26, unlike Mr. Clark's mapping.

[366] He referred to a 1993 map that was part of a submission by Amoco, the then-operator of the gas storage unit that became the CrossAlta storage facility. He testified that this map indicated that the Elkton extended a small way into Section 25. He also referred to a 1970 report from a Jefferson Lake technical committee that indicated that at that time, from their extrapolations, the committee was of the opinion that it expected to find 3 BCF of Elkton gas in Section 25, which is a much smaller volume than that suggested by Mr. Clark.

[367] None of these last three sources was mentioned by Mr. Clark in his written report, although he testified he was aware of them prior to preparing it.

[368] Mr. Clark conceded that in 1968, before the 7-25 Well was drilled, no gas in the Elkton formation had been found in any well south of the 10-36 Well in Section 36, and that no Elkton gas was found when the 7-25 Well was drilled. He also agreed that th 9-26 Well to the west and north of the 7-25 Well did not encounter Elkton gas, although according to Mr. Clark's mapping,

it should have had some Elkton porosity. Mr. Clark agreed that 3-D seismic data was not available in 1968 when the well was drilled.

[369] Mr. Clark also conceded that, in Kallisto's 2012 application to drill the 11-26 well, just west of the 9-26 well, the Kallisto team submitted that the proposed well would not encounter the Elkton D reservoir that was being used as a gas storage reservoir by CrossAlta, and that the Elkton reservoir was 1.2 kilometres from the site of the proposed well. That contradicts the opinion of the extent of the Elkton pool given in this trial by Mr. Clark. His explanation was that the ERCB defined the Elkton D pool differently and that, under its definition, the 11-26 well would not fall within those limits, explaining that the Kallisto position was "not a geology question, it's a "G" orders question".

[370] The Defendants submit that Mr. Clark is not impartial because of his connection to Kallisto and Mr. Lore.

[371] In Alberta, the Court of Appeal has directed that, with respect to questions of bias, the proper approach is to allow the expert to be qualified and give his opinion, and to analyze any objection related to bias by deciding on the weight to be given to the opinion: *Lameman v Canada (Attorney General)*, 2006 ABCA 392, rev'd. on other grounds 2008 SCC 14, [2008] 1 SCR 372.

[372] The Newfoundland Court of Appeal commented that the essence of this kind of challenge is that the evidence is not reliable because the expert has tailored his evidence to suit the position of a particular party: *Gallent v Brake-Patten*, 2012 NLCA 23, 321 Nfld & PEIR 77 at paras 89-93. Such an ultimate reliability issue calls for the court to assess the evidence in much the usual way, in a contextual manner, taking into account the whole of the evidence.

[373] It is clear that Mr. Clark has been associated with Mr. Lore for many years. In some English cases, the mere fact of a close and long-standing relationship is sufficient to impugn the evidence of an expert witness on public policy grounds: *Liverpool Roman Catholic Archdiocese Trustees Incorporated v Goldberg (No. 2)*, [2001] 4 All ER 950 at paras 11-13. However, it is not necessary that I decide on the weight to afford Mr. Clark's evidence merely on the basis of the close relationship. His opinion suffers from other deficiencies that affect its credibility.

[374] I give Mr. Clark's testimony little weight for the following reasons:

(a) Mr. Clark gave a materially different opinion in this litigation from the one he gave on the extent of the Elkton pool when he testified as a member of the Kallisto team at the 2012 ERCB hearings. His attempt to explain this contradiction at trial was not persuasive or credible;

(b) The primary source of Mr. Clark's opinion was a map tabled by CrossAlta in an ERCB filing. The map was the work product of a member of the CrossAlta team, who was not called to give evidence or even asked to give his consent to the use of the map. It apparently was part of a larger filing that was not produced in its

> entirety. Mr. Clark is not a geophysicist and is not qualified to give opinion evidence on seismic material. The map is a hearsay document. While experts are not precluded per se from using hearsay materials, the nature of this map, removed from its context, illegible in part and expanded by Mr. Clark with the addition of contour lines without adequate explanation of how these contour lines were arrived at affects the credibility and persuasiveness of Mr. Clark's opinions.

[375] For reasons that follow, I find Mr. Schorning's opinion evidence on the issue of the extent of the Elkton formation more credible and persuasive.

b. *Fred Schorning, P. Geol.*

[376] Mr. Schorning was retained by Nexen and ExxonMobil to provided an opinion on the original gas in place ("OGIP") for the Elkton formation in the area of Sections 25, 26, 35 and 36 of Township 27, Range 1 W5M, particularly the volume of Elkton formation gas available to be produced through the 7-25 well in 1968 when the well was drilled. He was asked to provide a rebuttal opinion to that of Mr. Clark and the co-author of his report, Mr. Pedersen with respect to the volume of gas that was available to be produced from the Elkton formation had a well been drilled into this formation from Section 25 Lands, including an opinion on the contour map prepared by Mr. Clark.

[377] Mr. Schorning is well qualified, a professional geologist registered with APEGGA who has been practicing for roughly 40 years. He was Vice-President of McDaniel & Associates from 1982 to 2005, responsible for identifying and calculating reservoir rock parameters and the associated mapping of those reservoirs. He testified that he is now semi-retired and a part-time consultant.

[378] Mr. Schorning was part of a team of Amoco geologists in 1964 to 1968 with responsibility for central Alberta and the Elkton zone, among other formations. He also was responsible for mapping the Elkton zone while with McDaniels in 1969 and 1970. He was qualified to give opinion evidence as a professional geologist in the area of subsurface and reservoir geology.

[379] In coming to his opinion, Mr. Schorning reviewed wells that had been drilled around the late 1960s, when the 7-25 Well was drilled, and then followed up his review after initial mapping with wells drilled in the late 1970s and early 1980s.

[380] He created a map of the limits of the Elkton zone using late 60s well data, and compared it with mapping of the Elkton zone published in 1968 by the Alberta Society of Petroleum Geologists with information from numerous oil and gas companies in Alberta.

[381] He is of the opinion that the Elkton zone ends between the 10-26 well and the 7-25 Well. He estimated, on the basis of information available at the time, that the southern pool limit of the Elkton zone was located halfway between the 10-36 well to the north of the 7-25 Well and the 7-25 Well. He admitted that this was somewhat arbitrary but explained that it was not a matter of

straight extrapolation to a zero point from data of the thickness of the Elkton formation from known well results, but that the formation likely ended in a cliff, drawing an interesting analogy to a cake on a plate.

[382] In Mr. Schorning's view, in 1968, two factors mitigated against drilling for the Elkton formation in Section 25, being:

(a) the price of gas, which made production only economical in large volumes, such as those encountered in the Crossfield formation; and
(b) the fact that a drilling spacing unit for natural gas in 1968 was one section, and a drilling target location had to be one of the inside four LSD's in a section. In his opinion, the Elkton zone would not be present under these 4 LSD's in Section 25.

[383] He noted that, at any rate, the 7-25 Well was drilled for the deeper Crossfiled zone and the Elkton zone was found to be absent. He also noted that between 1979 and 1981 four off setting wells were drilled within approximately one mile of the mapped Elkton zone and none of these wells encountered the Elkton zone.

[384] Mr. Schorning estimated that the areal extent of the Elkton zone in Section 25 is approximately 34 acres, and that the OGIP is thus approximately 0.123 BCF.

[385] Mr. Schorning's opinion and mapping of the probable limits of the Elkton zone differed in many respects from that of Mr. Clark (and Mr. Pederson's calculations, derived from Mr. Clark's work). He was cross-examined vigorously on various aspects of his opinion, including on the following issues:

(a) He was asked if he had reviewed any of the seismic data that was available in the 1960s for the area. He confirmed that he had not, but testified that he did not believe there was any available in the area. No evidence was adduced that such seismic data existed.
(b) He was asked about the map from the 1972 ERCB decision referred to by Mr. Clark in his testimony. Mr. Schorning testified that he was not aware of this decision, but noted that this included both the C and E pools, and that it is only the C pool that is in issue in this case. He also noted that the map indicated only 2.6 BCF in the two pools.
(c) He was asked about a TransCanada document that advised Jefferson Lake that TransCanada had identified just over 3 BCF of Elkton reserves under Section 25 Lands. He noted that this was just a number, with no attached analysis and with no information on how it had been arrived at.
(d) He was asked about the Jefferson Lake technical committee study that estimated 3 BCF of Elkton gas from Section 25, and conceded he had not seen it before. This is an early document that preceded the drilling of the 7-25 Well.
(e) He was asked about a pool map that was part of Amoco's 1993 application for approval of its gas storage facility, which appeared to map a significant Elkton presence on Section 25. He conceded he had not seen it before, noting it was

someone else's interpretation and not his. He also noted that this map showed about a third of the area of Elkton compared to Mr. Clark's opinion, and about a tenth of the volume of gas.

[386] Cross-examination of Mr. Schorning merely confirmed that the nature of geophysical mapping and assessing OGIP for the Elkton formation is a speculative process, and was even more so in the 1960s where the 7-25 Well was drilled. While I prefer Mr. Schorning's opinions to those of Mr. Clark and Mr. Pederson on the Elkton issues, it is not necessary for the purposes of this litigation that I make any findings on the issue of OGIP in the Elkton formation. The relevant question is whether it was imprudent for an operator not to drill for gas in the Elkton formation during the time period in question. On the basis of Mr. Schorning's evidence, I find that it was not.

c. *Paul V. Pedersen, P. Eng.*

[387] Mr. Pedersen is a petroleum engineer with over 33 years of experience. He was called as a witness by the Plaintiffs and was qualified to give opinion evidence as an expert in the area of reservoir and production engineering. While not a Kallisto employee, Mr. Pedersen has been a consulting engineer for Kallisto since 2011. He works much of his time in Kallisto's office and is the responsible member in engineering for Kallisto to enable Kallisto to meet APEGGA requirements. Approximately 95% of his professional work is for Kallisto. He worked with Mr. Lore at Rosetta Exploration from 1999 to 2006.

[388] Like Mr. Clark, Mr. Pedersen was involved in the 2012 Kallisto ERCB application as part of the Kallisto team. His role was to give ERCB testimony on "anything that pertained to reservoir engineering", particularly the Elkton formation and the 7-25 Well in the BQ formation.

[389] Mr. Pedersen was asked to provide an opinion on two issues:

a) whether the operator of the 7-25 Well sought to maximize production through the prudent application of standard oil and gas engineering practices, based on the production history of the 7-25 Well and surrounding wells; and

b) the volume of natural gas that was available to be produced had a well been drilled on Section 26 lands in the Elkton formation, based on an assessment of OGIP.

[390] Mr. Pedersen's expert report does not reference the data on which he relied, but in testimony, he described referring to well data and files from the ERCB, pressure data from Accu-Map, publicly available well logs and core reports.

[391] On the first issue, Mr. Pedersen compared production from the 7-25 Well with production from the 10-22 well and the 16-27 well, both of which had been operated by the same companies. In doing so, he compared cumulative production with flow capacity of the reservoir rock.

[392] Mr. Pedersen testified that he looked at the differences in production time among the three wells and saw what he referred to as an obvious disparity. He then concentrated on the efficiency of the completions that had been conducted on the three wells. In his view, the 7-25 Well had the best reservoir quality as far as net pay was concerned and higher overall average permeability. He looked at flow capacity ("Kh") numbers from three documents he had obtained, and came to the opinion that, assuming conditions were equal and the wells all flowed at full capacity, the 7-25 Well should have produced 45% of the total gas available in the reservoir, with the 11-22 well producing 41% and the 16-27 well producing 18%. In actuality, the 7-25 Well produced 15%, the 10-22 well produced 57% and the 16-27 well produced 18%. Mr. Pedersen also looked at comparative completion efficiency data and concluded that there had to be a reason why there was a big disparity in the production numbers. He looked at how the completions were carried out and how the wells were stimulated. He concluded that the 7-25 Well should have been better stimulated, that it hadn't been given a chance to be completed properly. He testified that a prudent operator would have carried out a "large foamed acid fracture" on the well. He also gave the opinion that there appeared to be "a deliberate lack of action on behalf of the operator", who would be draining the 7-25 Well's reserves using the other two wells where the operator (Nexen) had a significantly higher working interest.

[393] Mr. Pedersen conceded that his opinion was only sustainable if his assumptions on production hours and Kh numbers were correct. He was referred to test results for different periods of time on the 10-22 well and the 16-27 well that showed different Kh numbers. He submitted that the numbers he had chosen from the three pages of test results attached to his written report were representative numbers and that the others were misleading, blaming the differences on testing error.

[394] With respect to his opinion relating to deliberate lack of action, Mr. Pedersen conceded he had no personal knowledge of the operator's conduct to support such an opinion. He agreed that, given that Amoco had drilled the 7-24 well which would add to the drainage of the Crossfield formation, it was prudent for CanOxy to drill other wells to counter that, however, he suggested that a prudent operator would want to produce all wells all the time. He conceded that there could be a myriad of reasons to explain why a well was not producing compared to another well, some of which might have nothing to do with an operator's intention and that may be beyond the operator's control. He also conceded that some of the factors that contributed to a negative completion efficiency number may not be correctable and could be beyond the control of the operator.

[395] Mr. Pedersen asserted that there was no "frac" conducted on the 7-25 Well, although he conceded that the term "acid squeeze" could be used in the industry as a phrase for a "frac". He testified that the "acid squeeze" that was conducted on the 7-25 Well was different from what he would characterize as a "frac". He conceded that if he assumed that a frac was performed on the well, that would change his opinion.

[396] For the reasons that follow, I prefer the opinion of the Defendant's expert, William R. Freeborn on this issue. In addition to the reasons outlined in my comments on Mr. Freeborn's

evidence, I note that, like Mr. Clark, Mr. Pedersen is closely connected with Mr. Lore. While he is a consultant rather than an employee of Kallisto, Kallisto is his major client and he was part of the Kallisto team at the ERCB hearings in 2012. For that reason, I find that his opinion suffered from the appearance of partiality.

[397] On the second issue, the volume of natural gas from the Elkton formation that would have been produced had a well been drilled, Mr. Pedersen used Mr. Clark's map in his assessment. He used an AccuMap feature that generated the area of each contour line inserted by Mr. Clark, concluding from his calculations that the OGIP under Sections 25, 26, 35 and 36 would be 36.82 BCF, and that section 25 thus contained 11.3 BCF of gas that has never been produced as a result of a failure to drill a well in the Elkton zone. He testified that if the operator had drilled a well a few hundred meters to the north and west of 7-25 Well, it would have encountered the Elkton reservoir in accordance with Mr. Clark's map.

[398] Mr. Pedersen conceded that if Mr. Clark's contours were inaccurate, that would impact his opinion.

[399] As indicated previously, I have given Mr. Clark's evidence with respect to the extent of the Elkton zone little weight. It follows that Mr. Pederson's calculations with respect to the volume of natural gas from the Elkton formation that would have been produced had a well been drilled should also be given little weight. For the reasons I have given, I prefer Mr. Schorning's opinion on this issue.

d. Cameron P. Six, P. Eng.

[400] Mr. Six, a Vice-President, Engineering of Sproule Associates Limited with over 33 years of experience in the oil and gas industry, was called by the Plaintiffs and was qualified to give opinion evidence as an expert in the evaluation of oil and gas properties and reservoir engineering.

[401] Mr. Six was asked:

(a) to examine the economics of the Crossfield (Wabamun) zone and the BQ zone and determine if there was any point in time between 1995 and 2001 when it was economic to produce the Crossfield zone or the BQ zone and if there was any point in time during that period when it was economic to recomplete the BQ zone; and

(b) to review the production practices of the 7-25 Well compared to offset Crossfield wells to identify whether the 7-25 Well would have been able to produce additional volumes if it had access to processing capacity.

[402] On the first part of the first issue, Mr. Six prepared cash flow forecasts to determine if there was an economical market for production from the Crossfield zone at any time between 1995 and 2001. He prepared his forecasts on the basis of two scenarios:

a.) where the well owners were not owners in the TAQA (Amoco) Plant; and
b) where the well owners were owners in the TAQA (Amoco) Plant.

[403] The scenario where the well owners were owners in the TAQA Plant was done on the assumption that the well owners held an interest in the plant consistent with their interests in the unit agreement. Mr. Six did not attempt to analyze the situation where some well owners had interests in the plant and others did not, but, to keep it simple, assumed in the second scenario that the operator did not have to pay capital fees when processing gas through the plant. The actual evidence, which I accept, is that the Defendants were charged processing fees as if they were not owners in the TAQA Plant, so that Mr. Six's second scenario is of little assistance in determining whether there was an economical market.

[404] With respect to the non-owner scenario and the Crossfield zone, Mr. Six concluded from his cash runs that product prices were sufficient to provide a break-even cash flow at January 1 of 1995, that product prices were too low to justify reactivation on January 1 of 1996 to 1999, but were sufficient that positive cash flow for an extended period would have been realized from reactivation on January 1 of 2000 or January 1 of 2001.

[405] There are problems with the assumptions used by Mr. Six that affect the validity of his opinions to the actual facts. First, he assumed revenue from sulphur sales in his calculations, assigning an Alberta-wide average price for sulphur demand from ERCB statistics for the years at issue. The evidence from Mr. Seredynski, which I accept, is that there was no viable market for sulphur from the 7-25 Well during these years, and that it was stock-piled, creating an expense for the well-owners rather than any revenue. While this stock-piled sulphur may have had a value in the future years (the evidence is that it was sold in the mid-2000s), a prudent operator would not have attributed revenue value to it during the shut-in period.

[406] The second issue is that the cash flows appear to be based on an assumption that surface loss or shrinkage attributable to gas from the 7-25 Well was 51%, based on a reference made in an economic summary attached to a 1982 memo by a CanOxy employee. Other evidence which I accept is that shrinkage was actually in the order of 65%, which would have a material negative effect on the economics run by Mr. Six.

[407] A third problem is that, in running his cash flow analysis for that year, Mr. Six did not recognize the actual fact that the 7-25 Well was not shut-in until July 1995. Despite his stated opinion that this was a break-even year, his forecast actually showed negative cash flow in that year even without recognizing real gas prices for the first six months.

[408] Finally, Mr. Six failed to take into account the capital costs necessary to reactivate the 7-25 Well once it was shut-in, and conceded that this would be an additional negative factor on his cash flow analysis.

[409] Mr. Six conceded that if sulphur revenues were taken out of his year 2000 economic analysis, it would reduce cash flow to roughly $41,000, and that, depending on the estimate of capital costs necessary to reactivate the well, that positive number could turn into a negative

number. Thus, even without taking into account the incorrect assumption with respect to shrinkage, Mr. Six's opinion that product prices were sufficient to activate the 7-25 Well in 2000 is not sustainable. While the 2001 number may still have been positive after making adjustments for sulphur revenue, shrinkage and capital costs, the fact is that the 7-25 Well was actually recompleted in early 2001.

[410] Mr. Six also gave an opinion with respect to this scenario that, assuming an average sulphur price of $15.00/LT, a gas price of only $2.00/MMBTU would have been required to create a break even cash flow for the first year after reactivation. He noted that this gas price was realized on a continuous basis starting in October 1998, and therefore, he was of the opinion that, from this point forward, it would have been economical to reactivate the Crossfield zone in the 7-25 Well. However apart from the problem of the lack of sulphur revenue, Mr. Six conceded that, from his own data, when gas prices actually reached $2.00/MMBTU, the average price of sulphur did not reach $15.00/LT.

[411] With respect to the Crossfield scenario where the well owners are owners in the TAQA Plant, Mr. Six concluded from his cash flow runs that product prices were sufficient to provide a break- even cash flow at January 1, 1997, and that product prices were sufficient such that that positive cash flow for an extended period would have been realized from reactivation on January 1 of all other years between 1995 and 2001.

[412] When the cash flows are adjusted by removing sulphur revenues and adding capital costs, the barely positive cash flows in 1995, 1996, 1998 and 1999 in this scenario become negative, and the 1997 cash flow becomes even more negative. It is unclear what the cash flows for 2000 would be, but even if they were positive, they would be barely positive without adjusting for actual shrinkage. While the 2001 cash flows may still be positive, the 7-25 Well was re-activated in that year in any event.

[413] Mr. Six gave a similar opinion in this scenario, that assuming an average sulphur price of $15.00/LT, a gas price of only $1.24/MMBTU would have been required to create a break- even cash flow for the first year after reactivation and that, since this gas price was realized on a continuous basis starting in November 1996, from this point forward, it would have been economical to reactive the Crossfield zone in the 7-25 Well. This opinion is not sustainable for the reasons previously given.

[414] Mr. Six also prepared cash flow forecasts to determine if there was an economical market for production from the BQ zone without any additional capital investment at any time between 1995 and 2000. However, he conceded that there was no reality to this scenario, as it was clear that reactivating the BQ formation would require capital investment.

[415] With respect to cash flow forecasts to determine if it was economical to recomplete and tie-in the BQ zone at any time between 1995 and 2001, Mr. Six opined that, with respect to both the scenario where the well owners were not owners in the TAQA Plant and where the well owners were owners in the TAQA Plant, product prices were sufficient to provide attractive profitability indicators for the recompletion and tie-in of the project for all years except 1996. In

1996, Mr. Six described the profitability indicators as poor for the non-plant owner case, and marginal for the plant owner case.

[416] In these scenarios, Mr. Six assumed that there would be revenue from pentane and butane from a well in the BQ zone. He conceded that if no such revenue was obtained, his cash flow runs would be negatively affected. Evidence that I accept indicates that only an insignificant amount of revenue from these liquids was obtained when the 7-25 Well was actually recompleted in the BQ zone, since the TAQA Plant was not able to remove other than a very small amount of these liquids.

[417] Taking that adjustment into consideration, Mr. Six testified that the economics would be negative in 1996 and 1997 in the non-ownership scenario and negative in 1996 for the scenario where the well owners owned an interest in the plant, but still economical in all the other years.

[418] Mr. Six's scenarios for the BQ zone do not take into account that the 7-25 Well was producing in the Crossfield zone for the first half of 1995. Thus, it is only the cash flows for the years from 1996 to 2001 that are relevant.

[419] Mr. Six agreed that, in scenarios such as these ones where there needed to be an expenditure of capital to recomplete a well, a producer would normally be looking for attractive or acceptable returns before proceeding, the "profitability indicators" or "hurdle rates" he referred to in his opinion. He identified these hurdle rates as being rate of return, payout period, profitability index non-discounted and profitability index discounted at 10%. He conceded that companies would have different hurdle rates, that they may change from time to time, and that he wasn't using the actual hurdle rates of the operator of the 7-25 Well in his analysis. He testified that the hurdle rates he used were typical in the industry.

[420] He agreed that in his analysis of non-owner economics for the BQ zone in 1998 that at these prices, a well owner would not fully recover its capital costs until 2007, and for 1999, not until 2008. Full recovery for 2000 would only be achieved by 2011. The same analysis would hold true in the plant owner scenario.

[421] Mr. Six conceded that since BQ zone resources were not extracted from the 7-25 Well in the years 1995 to 2001 when gas prices were relatively low, but after 2000 when prices increased dramatically, the freeholder Plaintiffs received higher royalties for the gas produced than they would have had production started earlier.

[422] In summary, before Mr. Six's opinion is compared with that of the Defendant's expert, Mr. Seth, I find that Mr. Six's opinions with respect to whether there was an economical market for production from the Crossfield zone at any time between 1995 and 2001 are unsustainable because assumptions he used are not consistent with the evidence I accept. His opinions with respect to whether it was economical to recomplete and tie-in the BQ zone at any time between 1995 and 2001 after taking into account certain factors established by the evidence amount to an opinion that the economics would be positive in 1998 to 2006 in the non-ownership scenario and 1997 to 2000 in the plant ownership scenario. For reasons set out later in this judgment, I prefer

the opinion of Mr. Seth on the issue of whether it was economic to reactivate the 7-25 Well during these years.

[423] With respect to the second issue addressed by Mr. Six, a review of production practices of the 7-25 Well, Mr. Six gave the opinion that it was likely, based on the success achieved with acid fracture stimulation on offset wells, that significant productivity improvement could have been realized on the 7-25 Well had an acid fracture stimulation been done on the 7-25 Crossfield zone.

[424] He noted that the extensive downtime experienced by the 7-25 Well was partly a result of only having access to best efforts processing capacity at the TAQA Plant. He also noted that the offset producers did not experience the same intermittent production practices as at the 7-25 Well, and were able to produce for significantly more hours and produce significantly more gas than the 7-25 Well. He gave the further opinion that if the 7-25 Well would have been stimulated in the same fashion as the offset wells and had access to unrestricted processing capacity, it was reasonable to assume that the 7-25 Well would have recovered a gas volume equivalent to the average volume produced by the offset wells from the time that the 7-25 Well came on-stream in 1981 to the present.

[425] He noted that the average cumulative production from the 7-25 Well and the four offset wells from March 1981 (when the 7-25 Well came on-stream) to 2011 was 12,466 MMCF per well. Actual cumulative production from the 7-25 Well was 5,158 MMCF which is 7,308 MMCF less than its equitable share based on the actual average production of the 7-25 Well and the immediate offset wells. Thus, in his view, the estimated undiscounted cash flow of the 7,308 MMCF of lost production was 9,027 million dollars. Mr. Six testified that when he looked at data for the 7-25 Well compared with the closest immediate offset Crossfield formation wells, he noted that it had an intermittent production history. He commented that the 7-25 Well produced for far fewer hours than, for instance, the 16-27 well or the 10-36 well. He said that it was clear to him that the 7-25 Well was not able to access consistent processing capacity as compared to the offset wells and that was an obvious reason for the disparity in actual production time, which he found verified in documents in which the operator expressed concerns processing the gas through the TAQA Plant.

[426] Mr. Six testified that he also reviewed the completion of the 7-25 Well. He said that he was advised by Sproule in-house geologists that the 7-25 Well was comparable in porosity and permeability to the other wells. He noted that the well was completed with a foamed acid stimulation over a two-day period. He looked at the "skin factor" of 7.2, which he felt indicated significant wellbore damage and additional opportunity for increased rate. He stated that he assumed that the reason why another stimulation was not done was that the well was restricted in terms of plant capacity.

[427] Mr. Six's lost production calculation was performed by comparing an "average well" production derived from the average of the cumulative production from the 7-25 Well and four offset wells to the 7-25 Well.

[428] Although it did not form part of his written opinion, Mr. Six testified that the preferred course of action with respect to the 7-25 Well would have been to access unrestricted processing capacity, and that the operator should have pursued the BQ zone later, after it had dealt with the competitive drainage situation in the Crossfield zone.

[429] Mr. Six conceded in cross-examination that there were factors why a well didn't produce to a certain level that could exist regardless of the best efforts of the operator, including nil nomination periods dictated by TransCanada. He admitted he had not taken the various gas contracts relating to the 7-25 Well and the offset wells into account in his analysis.

[430] He also conceded that there were some factors relating to the "skin-factor' number that could be beyond the control or efforts of an operator, that a skin factor could change over time and that there was no guarantee that further stimulations would actually increase a well's productivity or decrease the skin factor. For reasons set out later in this decision, I prefer the opinion of Mr. Freeborn on the issue of production practices.

e. Wazir C. Seth, P. Eng.

[431] Mr. Seth was called by the Defendants Nexen, ExxonMobil, Bonavista and Coastal to provide expert testimony to rebut Mr. Six's opinions with respect to whether there was an economical market for production from the Crossfield or BQ zones between 1995 and 2001 sufficient to reactivate either of these zones.

[432] Mr. Seth is a professional engineer, currently a consultant. Prior to 2007, he worked for 38 years in various capacities with McDaniel & Associates Consultants Ltd., from evaluation engineer commencing in 1968 to Chairman from July 2006 to February 2007. At the start of his career in 1966, he was a production engineer with Amoco and had some experience with its Crossfield formation wells. Mr. Seth was qualified to give opinion evidence as an expert in the evaluation of oil and gas properties and reservoir engineering.

[433] Mr. Seth was asked to give his opinion on whether shutting-in the 7-25 Well in 1995 was justified and whether, during the shut-in period from 1995 to 2001, it would have been reasonable to bring the 7-25 Well on production, keeping in mind company attitudes at the time and looking at what a reasonable and prudent oil company would do. He was also asked to comment on Mr. Six's report.

[434] He concluded that the 1995 shut-in was justified and appropriate. In Mr. Seth's opinion, reactivation of the 7-25 Well in the shut-in period was never economical given that sulphur could not be sold. He was of the view that it would not have been commercially prudent to consider taking steps to recomplete the BQ formation until the second or third quarter of the year 2000.

[435] Mr. Seth noted that natural gas prices collapsed in approximately 1987 due to oversupply and restricted pipeline capacity. He testified that, after deregulation of gas marketing in the 1980s, competition in gas marketing was fierce, and the pricing situation was bad.

[436] Mr. Seth also noted that surface loss with respect to the 7-25 Well in the Crossfield zone was approximately 65% , leaving 35% of volume available for sale. Mr. Seth derived this figure from Coastal's 1995 operating statement, from which he calculated the volume of sales gas and compared that to data on raw gas production. He noted that this was the only reliable way to measure shrinkage. He commented that he had to "dig" for this information, and was of the view that Mr. Six didn't have full information. While Mr. Six's method of analysis may be generally correct, he did not take into account gas used in production on this particular well. I accept Mr. Seth's calculation as the actual level of shrinkage with respect to the 7-25 Well in 1995, which was corroborated by Mr. Seredynski's evidence. While this opinion was tested by cross-examination, it remains persuasive and reasonable.

[437] The difference in shrinkage calculations formed one of the differences between Mr. Seth's analysis and that of Mr. Six. In addition, Mr. Seth's opinion reflected the fact that during the 1995 to 2001 time period with respect to this well, sulphur price was negative, taking into account transportation costs and actual contract prices. Mr. Seth testified that he agreed in the main with Mr. Six's figures with respect to raw gas reserves and decline rates, although he used a decline rate of 25% rather than 24%. He also largely agreed with Mr. Six's field operating costs, but disagreed with his processing costs analysis. Mr. Seth added in to his calculations the capital costs necessary to reactivate the Crossfield zone in the amount of $135,000 until July 2000, and in the amount of $200,000 thereafter.

[438] The Plaintiffs are critical of Mr. Seth's estimate of capital costs, based on Mr. Seredynski's evidence about the cost of retrieving a tubing plug and removing an inhibitor, but Mr. Seth's estimate refers to the further steps necessary to reactivate the Crossfield zone, and I accept his evidence as reasonable, given the nature of this highly sour gas well.

[439] Mr. Seth and Mr. Six were in agreement that there should not have been any reactivation of the 7-25 Well in the Crossfield zone from 1996 to 1999 in the scenario where gas was processed as a non-owner at the TAQA Plant, and it is therefore not necessary to discuss their differences in approach with respect to these years. With respect to Mr. Six's original opinion that conditions were sufficient to reactivate the Crossfield formation in 2000 and 2001, I found that Mr. Six's opinions with respect to whether there was an economical market from the Crossfield zone at any time between 1995 and 2001 were unsustainable given that the assumptions he used with respect to sulphur revenue, shrinkage and capital costs were not consistent with evidence that I accept. However, I will briefly describe Mr. Seth's comments on these opinions.

[440] Mr. Seth referenced Mr. Six's faulty assumptions with respect to sulphur revenue and capital investment and commented further that there may have been issues of the 7-25 Well's bottom hole condition when reactivation was contemplated, given that it was an extremely sour gas well.

[441] Mr. Seth also chose to use the McDaniels' price forecasts in use at the time, rather than, as Mr. Six did, looking at the previous year's prices and forecasting forward, explaining that in a

downward process trend, an operator cannot make decisions for the following year on prices going down. The Plaintiffs submit that Mr. Six's approach, was more conservative, but I accept Mr. Seth's comments that this depends on the trend of prices, and that, in a volatile and declining market, looking backwards is not particularly conservative nor the best way for a particular year.

[442] As indicated in the *Freyberg* Liability Decision at para 72, "economics is at least as much an art as it is a science". Both Mr. Six's approach and Mr. Seth's approach to pricing forecasts were valid choices, and neither choice is determinative. In Mr. Seth's analysis, reactivating the Crossfield formation in 2000 and 2001 would have been clearly uneconomical.

[443] With respect to Mr. Six's Crossfield formation scenario that involved gas being processed at the TAQA Plant as an owner, Mr. Seth noted that the operator at the time, CanOxy, had sold its minority ownership interest in the TAQA Plant in April 1995, and that this scenario was not supported by the underlying facts.

[444] Mr. Seth was extensively cross-examined on the issue of whether it was appropriate to run economic scenarios on the basis that well owners that may have had an interest in the TAQA Plant would have had a better economic case to reactivate the 7-25 Well by reason of having the benefit of lower processing fees. As Mr. Seth indicated, Mr. Six's alternate scenarios were run on the basis that all well owners would be entitled to lower fees without a capital fee component. It is clear that this was not the case, as not all well owners had an ownership interest in the TAQA Plant. It is also clear that CanOxy as operator was not a plant owner when the 7-25 Well was shut-in in 1995, and that it was not entitled to preferential processing fees. Mr. Lakhoo of Coastal testified that, while Coastal had an ownership interest in the TAQA Plant, the processing fee for the 7-25 Well would be negotiated between the operator of the well and the operator of the plant. He confirmed that Coastal paid the same processing fee as the other owners of the 7-25 Well, whether or not they owned interests in the plant, and that Coastal did not believe it could ever have obtained a reduced fee.

[445] There is evidence that in 2001, ExxonMobil requested of Nexen as well operator and Prime West as plant operator of the reactivated 7-25 Well that it not be charged a capital fee for gas processing, as it had a significant ownership position in the TAQA Plant and excess processing capacity. No evidence was adduced whether this request was granted. At any rate, this was after the shut-in period and with a new plant operator. There is also evidence in the form of the 1980 Processing Agreement and the 2001 Processing Agreement, neither of which make any distinction with respect to the processing fees to be paid by owners of the 7-25 Well based on whether or not they were owners in the plant.

[446] I accept as credible and persuasive Mr. Seth's opinion, based on his experience and understanding, that a non-unit well like the 7-25 Well would be charged a third-party processing fee, and that the most that can be said is that plant owners would get an indirect benefit due to their entitlement to a share of third-party processing fees when the plant accounting is done. Given that, I agree that Mr. Six's scenarios that simply calculate the economics on a 100% plant owner basis are not relevant in this case.

[447] Mr. Six's opinion with respect to the BQ zone was that, after adjusting for the fact that there would be no revenue from pentane or butane from a well in the BQ zone, there would have been an economical market for production from that zone from 1998 to 2001 in the non-ownership scenario and 1997 to 2001 in the owner scenario. As I have indicated, the plant owner scenario is problematic, and does not reflect the reality of the situation, and I accept Mr. Seth's opinion that Mr. Six's economic runs in these scenarios are not supportable.

[448] With respect to the economic analysis of recompletion and tie-in of the BQ zone as a non-owner of the TAQA Plant, Mr. Seth indicated that he approached his analysis from the point of view of an operating company, looking at rate of return, profit to investment ratio and pay-out period. He noted that projecting forward was difficult, and that economics would have to be compelling before an operator would decide to proceed. He commented that operators would want to be assured that prices have stabilized and that there is an upward trending curve.

[449] Mr. Seth was of the opinion that recompletion in the BQ formation was not economical in 1996 and 1997. Given the conclusion I have reached about Mr. Six's original opinions with respect to those years, I will not analyse his opinions in detail.

[450] Mr. Seth's economic runs showed that in 1998, while the rate of return was improving, it was still below hurdle levels and payout would be in five years. In Mr. Seth's view, the payout period for this property should be less than two years.

[451] He noted that in 1999, cash flow was "becoming a little more interesting," with a better rate of return number, but that the profit investment ratio was not favourable, so that the project would not meet the minimum hurdle level. He also noted that a payout period of about three years was too long for the project. He was thus of the opinion that the project did not meet two out of the three economic criteria (rate of return, profit to investment ratio and pay-out period) for reactivation.

[452] Mr. Seth testified that the economic criteria he was applying were not arbitrary, but based on his experience in advising a number of clients in this time period. In these years, clients were looking for a rate of return in excess of 15% , payout in less than three years and a profit ratio of a minimum of two. These criteria represent average hurdle rates that he was accustomed to seeing over a period of time. While there is not a great deal of difference between Mr. Six's "hurdle rates" and Mr. Seth's "hurdle rates", I prefer Mr. Seth's assumptions in this regard. I accept that they are consistent with the approach taken by the oil and gas industry during the shut-in period in issue.

[453] Mr. Seth testified that his January 2000 cash flow analysis showed that the project met the economic criteria, in that it showed a profit investment ratio of more than two, a positive rate of return and payout in two years. In his view, it met the minimum hurdle level. However, this was not the whole picture. While these economic runs showed a more or less positive net worth, a well owner would have to have some confidence that natural gas prices were sustainable and increasing. He testified that the focus was not just on economics but also on commodity prices. In his view, producers would be starting to look at the gas price in the fourth quarter of 1999.

Most producers would be looking seriously at the price in the first half of 2000, and in the second and third quarters, many companies would have been making decisions to go ahead with projects. Given that some leeway time is reasonable, Mr. Seth was of the opinion that the case for reactivation of the 7-25 Well in the BQ zone became compelling in the third quarter of 2000. He noted that it was in this time period when Triquest began proceedings to obtain the necessary approvals to drill and operate the 7-25 Well.

[454] Mr. Seth in his written opinion noted that the recompletion of the BQ zone would have generated positive cash flow, but that this assumed that a contract was in place for the purchase of BQ formation gas from 1995 to 2001. He conceded that he was not aware, when he prepared his report, that a contract was in place with TransCanada. However, he testified that even if there were a contract, none of the companies were honouring their take-or-pay obligations in these years given low demand.

[455] Mr. Seth was asked on cross-examination whether, given the fact that the project met all profitability indicators in 2000, a prudent operator wouldn't have turned the well on the next day. He indicated that this was a difficult question, that operators would still have to look at the future prices and have confidence that existing prices were stable and would increase. He indicated that an operator might want to wait a little bit. He testified that the project at that time would have met the minimum criteria but that he would not consider the economics compelling yet.

[456] Mr. Seth conceded that the had not run any cash flow analysis to indicate when during the 1999 year the project may have met the economic criteria.

[457] Mr. Seth did not assume any revenue from propane and butane in his opinion, as he was satisfied with an ERCB document indicating that the TAQA Plant had no capability to recover these liquids. He explained during cross-examination that the plant was a "shallow cut" plant that was capable of recovering a few barrels of this liquid. The documentation supports that revenue from these small amounts was insignificant.

[458] Mr. Seth agreed with Mr. Six with respect to the amount of capital costs required for reactivation, and used a similar decline rate. There was not a great variation with respect to remaining natural gas reserves between the two opinions. There was agreement with respect to field operating costs.

[459] Mr. Seth pointed out that Mr. Six used the Edmonton reference price for the sale of all of the liquids, but that liquids had to be transported by truck from the TAQA Plant, and that therefore, there should be an allowance for transportation costs, which he included. He applied a 45% discount to the Edmonton reference price.

[460] Mr. Seth conceded on cross-examination that a more accurate way to calculate what the discount would be would be to take the average of a five-year span of revenue and operating statements, but that the best information he had was Coastal's 2001 data. He also conceded that

he was not able to determine from as documentation whether or not the 2001 gas price including a premium for the fact that the richer pentane and butane had not been stripped out.

[461] The opinions also differed on processing and gathering fees. Mr. Seth pointed out that Mr. Six used the processing fees from a 2001 contract between the operator and the then new plant owner, but Mr. Seth used a higher number, equivalent to the processing fee paid by the government during the shut-in period. Since issuing his opinion, he had been referred to the actual contract in place at the time with respect to Crossfield formation production, which he testified, supported his assumption with respect to processing fees.

[462] It became apparent during cross-examination that the contract in place at the time the well was shut-in was for processing sour Crossfield formation gas, and that the 2001 contract was for sweet gas. Mr. Seth ultimately conceded that the had no data as to what the actual processing fees would have been for sweet gas during the shut-in period. That, of course, is also true for Mr. Six.

[463] It appears from the evidence that, at the time the 7-25 Well was shut-in, the TAQA Plant had the highest processing costs of all plants listed in ERCB documentation, as it processed sour gas almost exclusively. Given that Amoco continued to be the plant operator until 2000, the only conclusion that can be drawn is that processing fees would likely have been in a range between the 87 cents used by Mr. Seth and the 59 cents used by Mr. Six. In the circumstances, I find that a prudent operator would likely have assumed the higher number in its calculations, which Mr. Seth testified was likely conservative in any event.

[464] It was suggested to Mr. Seth that since the difference in operating costs between his calculations and Mr. Six's with respect to operating costs was in the order of $500,000, if Mr. Six's operating costs were correct and this $500,000 was added to Mr. Seth's economics, this would make the recompletion of the BQ formation economical in all years from 1995 through 2001. While Mr. Seth conceded that this was correct, there is no dependable evidence of what the processing fees would have been had there been negotiations between the well owners and Amoco for the processing of BQ formation gas prior to Prime West becoming the operator of the plant in January 2000, and Mr. Six's calculations in this regard as speculative as Mr. Seth's. For the reasons I have given, I prefer Mr. Seth's estimate of processing fees, as reasonable for a prudent operator to use. At any rate, Mr. Six conceded that if revenues from pentane and butane were backed out of his analysis, the 7-26 Well would only have been economical to reactivate in the BQ zone from 1998 to 2001.

[465] In summary, I prefer the opinion of Mr. Seth on the issues that were before Mr. Seth and Mr. Six, as I accept Mr. Seth's assumptions as more reasonable than those of Mr. Six, and tailored more specifically to the circumstances of the 7-25 Well. While Mr. Seth may not have had a definitive answer to the question of whether some of the Defendants could have been entitled to preferential rates for processing, he had sufficient evidence of what was likely to have occurred to make his opinion more persuasive than that of Mr. Six, who assumed that all of the working interest owners would be entitled to a preferential rate, which was certainly not the case. While Mr. Seth may not have had all the facts relating to sulphur prices and the transportation of

liquids, his assumptions were closer to the reality of the circumstances of the 7-25 Well than those of Mr. Six. I accept that a prudent operator and prudent well owners would have evaluated the economics of reactivating this well during the shut-in period in much the same way as Mr. Seth, and would have reached many of the same conclusions.

[466] I accept Mr. Seth's opinions that:

a. it was justified and appropriate for the operator of the 7-25Well to shut-in production from the Crossfield formation in July 1995;
b. it was not economical or commercially prudent for the operator to reactivate the well in the Crossfield formation during the 1995 to 2001 time period; and
c. while the recompletion of the BQ formation would have generated positive cash flow, given the risks and uncertainties involved, it would not have been commercially prudent to take initial steps to recomplete the BQ zone until the third or fourth quarter of 2000.

[467] By the summer of 2000, Triquest, one of the well owners, began to develop a program to recomplete the BQ zone in the 7-25 Well, making offers to purchase interests and issuing an independent operations notice in November 2000. The last of those elections was received in January, 2001 and the recompletion program began approximately two weeks later.

[468] I therefore find that the well owners reactivated the 7-25 Well in the BQ zone shortly after it became economical and commercially prudent to do so.

f. William R. Freeborn, P. Eng.

[469] Mr. Freeborn is a professional engineer with 35 years of experience in the oil and gas industry. He was called by the Defendants to give expert opinion evidence as a petroleum engineer, including evidence with respect to reservoir engineering and production engineering.

[470] Mr. Freeborn was retained to provide a rebuttal opinion to that of Mr. Pedersen, specifically Mr. Pedersen's opinion on whether the operator of the 7-25 Well sought to maximize production through the prudent application of standard oil and gas engineering practices. He was also asked to respond to Mr. Six's opinion, specifically in respect of Mr. Six's comments on historic production practices with respect to the 7-25 Well.

[471] Mr. Freeborn is presently a consulting engineer, and has served more than 50 clients from 1995 to the present, including Devon Canada for about twelve years. He has experience in evaluation, including being part of an asset evaluation team at Devon that looked at underperforming wells to determine whether they could be successfully stimulated. He has performed forecasting work for the Government of Alberta, as well as working as a exploration engineer and a reservoir engineer.

[472] Mr. Freeborn described how "skin factor" is an encompassing term for an accumulation of things that may affect the performance of a well by increasing or decreasing the pressure gradient between the reservoir and the well bore. Some of these factors are within the control of

the operator, and others are not correctable by operator conduct. He demonstrated how the location of perforations into the reservoir has an impact on the magnitude of skin factor, noting that this is one of the factors within the operator's control. From the well data, he showed that, in respect of where holes were placed over the entire vertical height of the reservoir, the 7-25 Well was given more attention by the operator than the 10-22 well and the 16-27 well, giving it a more favourable skin factor. Mr. Freeborn concluded from the data that the operator of the 7-25 Well took action to prevent any partial penetration contribution to skin factor by perforating the entire pay interval, giving the 7-25 Well, insofar as fractional penetration is concerned, a skin factor of zero as compared to three for the 10-22 well and 6 for the 16-27 well. He noted that there was no evidence that Mr. Pedersen or Mr. Six considered this.

[473] Mr. Freeborn also indicated that there is a skin factor component that is rate dependent. While some of the rate dependence may be mitigated by perforation design, some is related to reservoir quality and is beyond the operator's control. He testified that with respect to perforation design and perforation density, the 7-25 Well had a far greater number of holes than the 10-22 well and the 16-27 well, leading him to conclude that the operator of the 7-25 Well had "treated the well kindly" in this respect and made effective use of perforating by only creating holes to access the best rock, and that shot density was approximately double the 10-22 well and 16-27 well. He noted that neither Mr. Pedersen nor Mr. Six mentioned this data.

[474] With respect to reservoir quality skin factor, which is beyond the operator's control, Mr. Freeborn turned to the "AOF tests" in the well data. He noted that the purpose of the test is to determine how much the well is capable of producing if produced at different wellhead pressures. Mr. Freeborn's testing showed that the 7-25 Well should be expected to produce less than the 10-22 well as a result of differences in reservoir property, a factor over which the operator has no control.

[475] Mr. Freeborn examined the density logs for the wells and noted that if a well has lower porosity, it usually has lower connectivity, which may be a factor leading to greater "skin". He concluded from the logs that the 7-25 Well had less porosity than the 10-22 well or the 16-27 well, and he would expect that the 7-25 Well would thus have a higher rate dependency skin.

[476] Mr. Freeborn disagreed with Mr. Six's opinion that the wells had similar reservoir quality, as in his view the 7-25 Well had less porosity. He noted that a second effect of different reservoir quality would be that the gas-in-place surrounding the 10-22 well would be 30% greater than the 7-25 Well.

[477] In summary, it was Mr. Freeborn's opinion that:

- by taking extra care to increase the perforation density, the operator reduced the potential for rate dependent skin at the 7-25 Well;

- the 10-22 well had the reservoir quality form of skin factor. It is so severe that were there no rate dependent skin, the well's productivity would be increased 29-fold;

- the 7-25 Well has poorer reservoir quality than the 10-22 well. This implies that it likely has a greater rate dependent skin sensitivity than the 10-22 well. Its lower porosity also means the 10-22 well's gas-in-place is 30% greater than the 7-25 Well.

[478] With respect to well stimulation, Mr. Freeborn testified that the words "fracture" and "acid squeeze" are used to mean the same completion operation and that the original stimulation treatment for each of the wells was essentially the same. He noted that the issue of whether the wells were fractured or not was to a certain extent semantics. While technically the 10-22 and 7-25 wells were both fractured on original completion, the fractures that were created were not large enough to be significant.

[479] Mr. Freeborn was of the opinion that the 7-25 Well's original stimulation was comparable, even better than the other wells. From data over time, he concluded that there was nothing to indicate that the 7-25 Well needed to be restimulated.

[480] In contrast, the 10-22 well was facing catastrophic failure and needed another stimulation. The original stimulation on the 16-27 well was effective, but the subsequent re-stimulation was not.

[481] In summary, it was Mr. Freeborn's opinion that:

- the wells were treated the same, except the acid treatment at the 16-27 well was completed without the need to exceed facture pressure;

- the 16-27 well was re-stimulated soon after production commenced with a very large gelled acid foam fracture. From the post-fracture production results, it would appear that the original stimulation was effective and the re-stimulation in February was not;

- contrary to Mr. Six's assertions, the 7-25 Well did receive an acid fracture stimulation.

- the fracture treatment for the 10-22 well, recorded by the ERCB and referenced by Mr. Pedersen and Mr. Six, was a high pressure acid squeeze similar to the treatment at the 7-25 Well;

- the 10-22 well was re-stimulated with a large volume acid squeeze above fracture pressure. The workover only restored the well to its original condition;

- Mr. Pedersen and Mr. Six refer to fracturing as being a positive event: one that well result in improved productivity. In Mr. Freeborn's opinion, a fracture is only needed when the reservoir quality is so low that fluid cannot be injected without a fracture, and that was not the case here.

[482] Mr. Freeborn commented that the original well stimulations were in accordance with the common practice of the day, and that the greater skin measured at the 7-25 Well was likely the result of rate dependent skin effects due to the well's lower porosity.

[483] Mr. Freeborn in his testimony and in his report gave a detailed explanation of why he disagreed with the opinions of Mr. Pedersen and Mr. Six. A summary of his opinion is as follows:

(a) Flow capacity is not the only factor that influences the production rate for a well. Mr. Pedersen's analytical techniques using only flow capacity are unable to predict the rates that the 10-22 well, the 16-27 well and the 7-25 Well actually produced, so it is difficult to believe they could accurately predict what might happen if operating and completion parameters were different. The assertion that potential recovery is only related to flow capacity ignores the fact that the 7-25 Well could not produce for extended periods (up to 6 months or more) because there was no market for the gas.

(b) The original completion of the wells was slightly different, but the difference favoured the 7-25 Well. The perforations at the 7-25 Well were more extensive, and the 7-25 Well received a much larger volume acid squeeze, and both the 10-22 and 7-25 wells were fracture stimulated. Stimulation above fracture pressure is not done to improve the quality of the acid squeeze treatment: it is done because the injection rate would be too low if fracture pressure were not exceeded. In this sense the need to fracture indicates lower reservoir quality.

(c) It was inferred by Mr. Pedersen that the positive skin factor at the 7-25 Well is solely related to the completion and stimulation effort of the operator because the 7-25 Well was not fractured. However, the operator's completion records indicate that the 7-25 Well was fractured. Further Mr. Pedersen does not mention that skin factor is a combination of reservoir flow dynamics and reservoir quality, some of which are beyond the operator's control. Those uncontrollable factors are likely the reason why the 7-25 Well did not perform as well as the other two wells.

(d) The 7-25 Well was completed like the 10-22 well. The test from which the 7-25 Well's flow capacity data was taken has anomalous pressure readings that indicate the 7-25 Well may be very close to the boundary of the reservoir. In such a situation, the 7-25 Well behaved like half a well with respect to production rate.

(e) The operator would have been motivated to produce all the wells at full capacity. The wells, being outside the East Crossfield Unit, were capturing 10-12% of the pool production from 7% of the wells.

(f) The drainage situation presented by Mr. Six implies that only four wells were draining reserves from the 7-25 Well. However, the Crossfield reservoir has 56 wells; 52 unit well and 4 non-unit wells. Prior to the drilling and first production from the non-unit wells, the reservoir was depleted of approximately 50% of the producible gas. Until approximately 1985, the unit wells were capturing more than their share of the production from Crossfield zone. Gas was moving north and being produced by the unit wells.

(g) The information Mr. Freeborn reviewed does not support the position that the cause for significant downtime at the 7-25 Well was the absence of adequate processing capacity. A firm service contract was held by the operator to ensure at least 2000 mcf/d of processing space for the 7-25 Well with the right to produce more when excess plant capacity was available. In Mr. Freeborn's opinion, extended downtime of up to 6 months occurred because there was no market for the gas.

(h) The logs for the 10-22 and 16-27 wells demonstrate similar reservoir quality. However, the porosity for the 7-25 Well is substantially lower than the other wells. With less porosity, the 7-25 Well would have less reserve for the same reservoir rock volume, and would have a greater likelihood of having damage that was beyond the operator's control.

(i) A fracture stimulation was conducted at the 7-25 Well, but in the public records it was termed an acid squeeze. For this reason, the productivity improvement that Mr. Six asserted could be available with a fracture was already done.

(j) In Mr. Freeborn's opinion, periods of extended shut-in for the 7-25 Well were due to the absence of a market, and there were few recorded production months where the producing rate was limited to the operator's firm processing capacity.

[484] Mr. Freeborn was thoroughly cross-examined on his opinions. The Plaintiffs suggested that the admittedly large number of corrections made by Mr. Freeborn to his opinion when he began his testimony resulted in significant changes to his report, but I am satisfied that he explained the changes, and that, as he testified, they did not change the substance of his opinion in a significant way. I do not find, as the Plaintiffs suggest, that Mr. Freeborn attempted to justify opinions based on incorrect information after the fact. In particular, I accept Mr. Freeborn's opinion that, in the circumstances of the data that was before him, he preferred to base his analysis on the logs, rather than core samples from the wells.

[485] Mr. Freeborn did not, as suggested by the Plaintiffs, concede that his conclusion that the re-stimulation of the 10-22 well caused more damage to it was incorrect: his answers on cross-examination on that issue were more extensive and nuanced than suggested by the Plaintiffs, and his credibility was not affected by a difference of opinion on this relatively minor issue.

[486] On the question of whether the fact that a 1978 test reported a high skin factor that should prompt an operator to conduct further operations, I accept Mr. Freeborn's explanation that an operator would look at that test result carefully, and discount it in light of other information.

[487] Mr. Freeborn was an impressive expert witness, knowledgeable and candid, and his credibility was not impaired under cross-examination. The intensive cross-examination merely served to illustrate that there is room for differences in opinion in interpreting engineering data about the 7-25 Well and the offset wells. Given the limited relevance of the expert opinion evidence relating to whether the operator of the well acted properly and prudently, it is not necessary to address each technical issue raised in cross-examination, nor to decide whether Mr. Freeborn is entirely correct in all aspects of his analysis. I prefer Mr. Freeborn's opinions on the whole to Mr. Pedersen's, given his greater impartiality and his greater demonstrated expertise. I prefer his opinions to that of Mr. Six on issues relating to production practices on the basis of the factors identified by Mr. Freeborn that were outside the operator's control.

g. Robert Charles Edney

[488] Mr. Edney is a senior partner and managing director with Acme Energy Marketing, which is in the business of aggregating supplies of natural gas from junior oil and gas companies in Alberta, British Columbia and Saskatchewan. Mr. Edney was called by the Plaintiffs as an expert witness in the field of gas markets and gas marketing.

[489] Mr. Edney has extensive experience in the oil and natural gas industry, having worked for CanStates Energy and Bow Valley Industries/Canhunter Exploration as a manager, Duke Energy Canada Marketing as a Managing Director, and finally at Acme Energy as its principal and largest shareholder.

[490] Mr. Edney explained how the natural gas markets in Canada went through a dramatic change from the mid 1980s to the mid 1990s. In 1985, the deregulation of the natural gas market began. Deregulation of prices was accompanied by open access to transportation, transforming merchants, such as TransCanada, into transporters. Deregulation also created a new market place for natural gas, available on the NOVA pipeline system. As the market became more liquid and pricing became more competitive, natural gas became a homogenous commodity.

[491] The effect of deregulation was twofold. First, prices dropped immediately. At the same time however, because producers were able to sell directly to markets, gas that was shut in due to low rate takes by pipeline companies became available. Pipelines expanded along with demand and by the mid-1990s, prices began to rise. The period from 1995 to 2001 thus became one of escalating prices, growing demand and readily accessible markets for natural gas.

[492] As a result of the deregulation of the natural gas markets, Mr. Edney concluded that there was a very liquid and active market to buy and sell natural gas in and around the Crossfield area during the years from 1995 to 2001.

[493] Mr. Edney also noted that a gas purchase agreement existed between the producers and TransCanada concerning the 7-25 Well during the years from 1995 to 2001. He also identified other potential gas buyers for gas from the 7-25 Well, including electronic markets, industrial companies, local distribution companies, and large producers who purchased gas to shore up their own markets.

[494] Transportation capacity was available for the 7-25 Well according to Mr. Edney. He also testified that CanOxy/Nexen had the skill, sophistication and pipeline capacity to market and sell the natural gas at the delivery point or downstream.

[495] Mr. Edney concluded that there was no need to shut in the 7-25 Well, nor to keep it shut in during the period from 1995 to 2001 due to a lack of or an intermittent market. He testified that a spot market existed for gas from the 7-25 Well but that TransCanada would have been the logical buyer of the gas due to its gas purchase agreement with the producers.

[496] Under cross-examination, Mr. Edney conceded that the availability of numerous market opportunities for natural gas was dependent on a producer getting its produced gas to a receipt point on the NOVA pipeline system. Only once natural gas is delivered into the NOVA pipeline system can it be marketed.

[497] Mr. Edney also stated that the sour gas produced from the 7-25 Well would not be saleable at the NOVA receipt point without significant processing to remove impurities.

[498] As noted by the Defendants, Mr. Edney's evidence related largely to whether there was a market for natural gas in Alberta during the shut-in period generally, and not with respect to the 7-25 Well specifically, although he did reference the TransCanada contract. The issue is not whether there was such a general market, but whether there was a market for the 7-25 Well given the particular circumstances of that well. The Defendants do not argue that there was no general market, and submit that Mr. Edney's opinion is of limited utility to the issue of the interpretation of the lease, and I must agree.

C. Analysis - Have the Leases in issue terminated according to their terms as a result of the lack of production from August 1995 until January 20, 2001?

a. General Principles of Interpretation

[499] An oil and gas lease is a contract: *Omers Energy Inc v Alberta (Energy Resources Conservation Board),* 2011 ABCA 251, 513 AR 292 at para 33. In interpreting such a contract, the court should give expression to the intentions of the parties by examining the specific words in the context of the whole contract: *Kensington Energy Ltd v B & G Energy Ltd*, 2008 ABCA 151, 432 AR 141 at para 13. The intentions of the parties are to be determined on an objective basis, what a reasonable person would infer from the words used, the agreement as a whole, the factual and legal background and the practical objectives that the contract was intended to achieve: *Omers* at para 34.

[500] Where possible, effect is to be given to all of the terms of a contract. The parts of a contract are not to be read in isolation, but interpreted in the context of the intentions of the parties as evident from the contract as a whole: *BG Checo International Ltd v British Columbia Hydro and Power Authority,* [1993] 1 SCR 12 at paras 23-24.

[501] If the words of a contract are unambiguous, the court should not give it a meaning different from that which is expressed by its clear terms, unless the contract is absurd or has an effect clearly contrary to the intentions of the parties: *Scott v Wawanesa Mutual Insurance Co*, [1989] 1 SCR 1445 at 1467.

[502] Each dispute must be resolved by reference to the terms of its own lease. Previous decisions are often of little assistance, because of variations in lease language, different facts or because the point relied on is *obiter dictum*: *Kensington* at paras 15, 31.

b. Specific Lease Provisions

[503] There are two variations of lease language that must be analyzed in this case. One is contained in the Jefferson SW/4 Lease, the relevant terms of which are substantially identical in the Imperial NW/4 Lease. The other is contained in the Union NE/4 Lease.

[504] Each Lease commences with the identification of the parties, a description of the leased lands, the consideration and the specific granting language. It is followed by the "habendum clause", which, in conjunction with its provisos, describes the duration of the lessee's interest in the lease. The relevant provisions of these leases are set out in **Appendix C** to these reasons.

[505] The habendum clause of each Lease gives the lessee a lease for a primary term of 10 years and so long thereafter as leased substances are produced, subject to earlier termination as provided, followed directly by the three provisos.

[506] The first proviso allows the lessee to defer drilling during the first year of the primary term and for the following years by the payment of annual delay rental payments.

[507] The second proviso stipulates that if a dry well is drilled in the primary term prior to the discovery of production, or, if after production has commenced in the primary term, production ceases and the well or wells that were producing are abandoned, the lease terminates at the next anniversary date of the primary term unless the drilling of a further well has commenced or the lessee pays the delay rental for that year.

[508] The Third Proviso, which with its amelioration sub-causes is the issue in this case, provides that:

a) if at the end of the primary term, there is no production but the lessee is engaged in drilling or working operations on the lands, or

b) if after the expiration of the primary term, production has ceased and the lessee has commenced further drilling or working operations within 90 days of production having ceased,

the lease remains in force so long as such drilling or working operations do not cease for more than 90 days and, if the operations result in production, such production continues, with further clarification set out in the amelioration sub-clauses.

[509] Notwithstanding the emphasis on drilling, working and producing in the habendum clause, the Third Proviso allows exceptions set out in the amelioration sub-clauses. Under the Jefferson SW/4 Lease, if drilling or working operations are interrupted or suspended as a result of any cause whatsoever beyond the Lessee's reasonable control, or if any well on the pooled lands, is shut-in, capped, suspended or otherwise not produced "as the result of a lack of or an intermittent market, or any cause whatsoever beyond the Lessee's reasonable control", the time of such interruption, suspension or non-production is not to be counted against the lessee for purposes of the 90 day limit in the Third Proviso. Under the Union NE/4 Lease, if drilling, working or production operations are interrupted or suspended "as the result of any cause whatsoever beyond the Lessee's reasonable control including, in the case of production operations, lack of or an intermittent market", the time of such suspension is not to be counted against the lessee for the purpose of the 90 day limit in the Third Proviso.

[510] In summary, while these leases are based on the prospect of drilling and producing leased substances from the lands, and provide the lessee with ten years to do this at first instance and then an unlimited term if there continues to be production, they provide for certain eventualities where the primary term can be abbreviated (through failure to either drill or pay delay rentals as provided in the first proviso or failure to follow up on a dry well or an abandoned well in the primary term with further drilling or payment of delay rentals as provided in the second proviso) or the extended term can be terminated (by no production at the end of the primary term or cessation of production, unless further drilling is commenced within 90 days). To relieve against the possibility of termination in the extended term in situations where there has been production, but it has ceased, the 90 day period allowed by the Third Proviso gives the lessee the opportunity to drill again. The leases also allow relief to the lessee in the circumstances set out in the amelioration sub-clauses from the requirement of having to drill again within the 90 day period to keep the leases alive.

[511] Against this context, Clause 3 of the Jeffersen SW/4 Lease and Clause 2 of the Union NE/4 Lease (the "Shut-In Well Clauses"), which are included in the portion of the Leases that set out the covenants of the Lessor and Lessee, make good economic sense. If the Leases continue to run in the extended term because the Lessee has a well or wells on the lands that qualify under the amelioration sub-clauses and therefore do not require the Lessee to commence further drilling, the Lessor is put in a position where it will not receive royalties from production. At the same time, the Lessee is not required to produce or to recommence drilling. These clauses, therefore, balance lease obligations and rights by providing that, in such a situation, the Lessor is at a minimum entitled to a sum equal to the delay rental payment.

[512] In this case, the Shut-In Well Clauses mirror the habendum clause ameliorating provisos, and thus, the Defendants may rely on either the wording of the amelioration sub-clauses or the Shut-In Well Clauses to defend against the allegation that the Leases have terminated.

[513] Shut-in royalty payments were made pursuant to the relevant clauses, but the Defendants concede that, since the *Freyberg* Liability Decision, it has been established that payment alone is not sufficient to continue leases such as the ones at issue during periods of non-production.

c. *Onus*

[514] The Defendants bear the onus of establishing that:

a) with respect to the Jefferson SW/4 Lease and the Imperial NW/4 Lease, the 7-25 Well was shut-in or otherwise not produced "as the result of a lack of or an intermittent market, or any cause whatsoever beyond the Lessee's reasonable control"; and

b) with respect to the Union NE/4 Lease, the 7-25 Well was suspended "as the result of any cause whatsoever beyond the Lessee's reasonable control, including ... lack of or an intermittent market": *Freyberg* Liability Decision at paras 77, 80, 82.

[515] The Defendants do not suggest (that there was no market for the gas produced from the 7-25 Well. They submit, however, that the words "lack of or an intermittent market" should be interpreted in the same was as an "uneconomic or unprofitable market". They also submit that the 7-25 Well was shut in for causes beyond the Lessees' reasonable control.

[516] The Plaintiffs submit that the language of the Leases relating to a lack of or an intermittent market should be interpreted strictly and narrowly, and that the language "any cause whatsoever beyond the Lessee's reasonable control" should be interpreted to refer only to force majeure type events that are not in evidence in this case.

d. *Lack of or an Intermittent Market*

[517] The Defendants submit that when commercial realities and the underlying intention of the parties to a lease to make a profit are considered, the words "a lack of or an intermittent market" should be interpreted in the same manner as an "uneconomic or unprofitable market", the lease language considered in the *Freyberg* Liability Decision.

[518] They cite *549767 Alberta Ltd v Teg Holdings Ltd*, [1997] AJ No 321 (QB) as an example of a case where economic viability or profitability was an important factor in the analysis of a "lack of or an intermittent market". However, *Teg* is not persuasive authority on this issue, as it is distinguishable on its facts and does not support the proposition for which it was cited.

[519] The Defendants also refer to comments made by John Ballem to the effect that, where a well is shut-in because of "a lack of or an intermittent market or any cause whatsoever beyond the lessee's reasonable control", this means then the lessee must establish that the well is shut-in because of market conditions or some other cause beyond his control before he can take advantage of the clause: John Bishop Ballem, *The Oil and Gas Lease in Canada*, 4th ed

(Toronto, Ont: University of Toronto Press, 2008) at 105. The Defendants submit that this implies that, in Mr. Ballem's opinion, adverse market conditions would constitute an allowable basis for a freehold lease being preserved during a period of shut-in.

[520] The Defendants argue that the literal interpretation of "lack of or an intermittent market" suggested by the Plaintiffs would lead to an absurd result, with a lessee being required to produce a well at a loss or a break-even point if it sought to rely on the ameliorating sub-clauses to preserve the validity of the lease, a result that could not be considered the parties' intention when they entered into the lease with the intention of making a profit.

[521] They say that, in light of the realities of natural gas operation and markets, the Leases must be given a commercially reasonable interpretation, citing the comments of the Alberta Court of Appeal which refer to the "commercial reality at the time the parties entered the agreement": *Omers* at para 98.

[522] The Plaintiffs also rely on *Omers*, submitting that, in considering the commercial context for oil and gas leases and the appropriate balancing between the rights of lessees and lessors, "an interpretation suggesting a lessor would agree to tie up its land to a lessee beyond the primary term for speculative purposes only is unreasonable" : *Omers* at para 92.

[523] Given this mutual reference to *Omers*, it is important to note the context of the comments made in that case.

[524] *Omers* involved the interpretation of a suspended wells clause that allowed a lease to continue despite failure to produce for longer than 90 days if there was a well on the lands "capable of producing the leased substances". The habendum clause in the *Omers* case apparently did not include the kind of ameliorating sub-clause language that is included in the leases in this case, which allows the lease to continue if production is interrupted as a result of the "lack of or an intermittent market", or "any cause whatsoever beyond the Lessee's reasonable control".

[525] Justice Conrad commented in *Omers* that, despite the stringent nature of a habendum clause lacking such ameliorating provisos, the lease in question provided relief to the lessee in certain circumstances, citing the clause entitled "Force Majeure" and the suspended well clause. She noted that the language of the suspended well clause provided that when a well that was "capable of producing the leased substances" was shut-in or suspended, the lease continued as though operations were being conducted, protecting the lessee against the loss of its investment: para. 44. The Court noted with approval the comment of the ERCB that "the lease ... recognizes the practicalities of the oil and gas industry, which at times may present an environment in which it is not reasonable or even possible for the lessee to produce the well", citing inability to move product to market or unfavourable market conditions that made it prudent not to sell: para 44. Justice Conrad commented at para 45 that:

> These provisions, read together, demonstrate the general intention of both parties to discover and exploit available resources quickly and efficiently so that both parties can

> profit - the lessor through a royalty, and the lessee through the sale of the resource. The Force Majeure Clause and the Suspended Wells Clause are designed to afford the lessee some flexibility so that it does not lose the benefit of the lease through a catastrophe beyond its control, or temporary market or transportation conditions that make it unfeasible to produce.

[526] If the parties in this case had been operating under the kind of lease analyzed in *Omers*, there would be no question but that the leases would continue to be in force.

[527] As noted in *Omers*, the ERCB in that case found that the words "capable of producing the leased substances" in the Suspended Wells Clause meant capable of producing the leased substances "in meaningful quantities", a test that the lessee could not meet. The lessee argued that the interpretation of a freehold lease requires strict attention to actual wording and "a determinatively literalistic application of that language" : para 48.

[528] The Freehold Petroleum and Natural Gas Owners Association, which was represented at the ERCB hearing, argued for an interpretation of this clause synonymous with "capable of producing leased substances in paying quantities", a test set out in American authorities: para 15.

[529] The ERCB refused to read "paying quantities" into the clause, stating that this was not the wording used by the parties, nor an interpretation that was so well-established in the industry or under Canadian law that the ERCB could reasonably infer it to be what the parties intended: para 72. The Court agreed, commenting that words should not be read into a contract "unless the Court is satisfied that the parties intended to contact subject to those words" : para 76. However, Conrad, J.A. stated that, by making this finding, she was not rejecting the "general rationale" upon which the term "paying quantities" is based. She noted that she agreed with the ERCB and the American authorities "that the purpose and goal of parties entering into such a lease is to develop the resource for the purpose of making a profit", noting further that "[a]n interpretation which defeats the purpose of the parties in entering an agreement should be discarded in favour of an interpretation which promotes that purpose and a sensible commercial result" : paras 77 and 78.

[530] While the Court commented that an interpretation suggesting a lesser would agree to tie up its land to a lessee <u>beyond the primary term</u> for speculative purposes only is unreasonable, this was in the context of a scenario where, at the end of the primary term, there was no well drilled on the leased property that was capable of meaningful production. In this case, the 7-25 Well had produced for a number of years prior to being shut-in in 1995, earning profits that resulted in royalties paid to the freeholder Plaintiffs. As Conrad, J.A. noted, under the *Omers* lease, the fact that a well capable of production is shut-in for market conditions would not cause the lease to expire: para 93.

[531] On the issue of speculative shut-in, the Plaintiffs also refer to my comments in *Kensington* at para 66, to the effect that there is no good policy reason to allow a lessee to hold the leased lands indefinitely for purely speculative purposes. My comments in this case were in dissent, and the majority found that the payment of a shut-in payment resulted in deemed

production that allowed a lease to continue. In addition, these comments must be reviewed in the entire context of what was said, including what followed immediately at para 67:

> It may be argued that it is justifiable for a lessee to keep a lease alive even though drilling is not economic at a particular time, on the basis that improvements in technology or exploration procedures may later give the well some value. In that case, the third proviso provides an opportunity to do this as long as the well is shut-in in accordance with good oilfield practice, inserting a reasonable and somewhat objective limitation on the lessee's decision to shut-in a well.

[532] The Plaintiffs submit that Mr. Seredynski's evidence establishes that the operator of the 7-25 Well saw no future prospect of profitability, that Nexen had no reasonable expectation of profitable returns and that it was merely speculating by keeping the lease alive by shut-in payments. That is not a reasonable interpretation of Mr. Seredynski's evidence. He testified that the plan for the 7-25 Well at the time it was shut-in was to maintain it in Nexen's portfolio of properties and to review the situation from time to time to see if conditions in the market improved so as to make the well economical. He agreed that, at projected gas prices, he saw no future prospect for profitability for the 7-25 Well *for the following five years.*

[533] The Plaintiffs also argue that individual lessors have a legitimate expectation that their minerals would be produced as soon as possible, and certainly within their lifetime, citing the *Freyberg* Liability Decision at para 50. In this case, the freehold lessors received production royalties prior to 1995, and the shut-in period was for approximately five-and-one-half years, not twenty-one years as in *Freyberg.*

[534] The Plaintiffs submit that the case of *Blair Estate Ltd v Altana Exploration Co*, [1987] AJ No 554 (CA) is the leading authority on the language used in the habendum clauses of these leases.

[535] In five short paragraphs in *Blair Estate*, the Court noted that the issue in that case was onus of proof. The lessee had submitted that, in so far as its major customer, TransCanada, was concerned, the market was intermittent and the lessee thus could not market the gas to its major customers. However, the Court noted that there was evidence of the potential of discount commercial markets, such that the lessee did not prove that there was a lack of market for the natural gas produced in order to trigger the extension of the primary term of the lease.

[536] There is no reference in the decision to whether other reasons for the lack of a market were argued or presented in evidence, or even if the case involved a shut-in well. It is not persuasive authority for the proposition that the ameliorating language of the leases at issue in this case should be interpreted narrowly.

[537] The Plaintiffs submit that the argument that "lack of or an intermittent market" should be interpreted to mean a "lack of an economic or profitable market" cannot succeed because the Court of Appeal in the *Freyberg* Liability Decision rejected the argument that the lease in that case contained an implied term that "absent the ability to utilize the [timely payment of shut-in

royalties exemption], the lessees must produce gas from the land in the secondary term for such term to continue". The Court of Appeal noted that this implied term circumvented case law that states that failure to produce, when economical and profitable to do so, results in termination of the lease: *Freyberg* Liability Decision at para 47.

[538] The Defendants in this case do not suggest that the leases contain an implied term. They submit that the existing provisos should be interpreted in a commercially reasonable manner, given the leases as a whole and in the context of a mutual desire to make a profit from the extraction of the leased substances, such that concepts of commerciality and profitability form part of the interpretation. This was essentially what was done by the ERCB in *Omers*, confirmed in that case by the Court of Appeal.

[539] The Plaintiffs also submit that the "entire agreement" clauses in the leases preclude the interpretation sought by the Defendants. While the "entire agreement" clauses may prevent implied terms, they do not preclude the search for a reasonable contextual interpretation of existing provisions.

[540] In addition, the Plaintiff submit that the Defendants' suggested interpretation of the Third Provisos is untenable because:

a) no absurdity arrises from the plain reading of "lack of or an intermittent market". The Defendants submit that an absurdity does arise, in that under this interpretation, a lessee would be required to produce at a loss if it wished to maintain the lease in the anticipation of changing market conditions;

b) the "Offset Well" clauses in the leases provide that offset well obligations could be postponed pending the establishment of "an adequate and commercially profitable market". The Plaintiffs submit that because such language was used elsewhere in the leases, it should not be assumed that the parties intended to qualify the "lack of intermittent market" language in the same way. As the Defendants note, the offset well provisions of the leases have a completely different specific function that is not comparable to the habendum clause and its provisos.

[541] The submissions of the parties with respect to the proper interpretation of the "lack of or an intermittent market" focus on the proper interpretation of that limited phrase, but it does not exist in isolation in the Third Provisos. The Union NE/4 Lease allows a suspension of production not to be counted against the Lessee if such suspension is the result of "<u>any cause whatsoever</u> beyond the Lessee's reasonable control, <u>including</u> ... lack of or an intermittent market". The Jefferson SW/4 Lease allows the suspension of production not to be counted against the Lessee if such suspension is the result of "a lack of or intermittent market, <u>or any cause whatsoever</u> beyond the Lessee's reasonable control". A lack of market is thus either just an example of the kind of cause that may be beyond a lessee's reasonable control (in the Union NE/4 Lease), or an alternative to a cause that may be beyond a lessee's reasonable control in the Jefferson SW/4

Lease). Contextual reading of the phrase thus suggests a broader interpretation than the literal and narrow one submitted by the Plaintiffs.

[542] I find that the phrase "lack of or an intermittent market", read in context and with a view to the reasonable intention of parties to a lease to profit from the extraction of leased substances, should be interpreted to mean lack of or an intermittent economical or profitable market.

[543] However, that does not end the inquiry, and it is necessary to consider the remaining language of the ameliorating sub-clauses, "as the result of any cause whatsoever beyond the Lessee's reasonable control".

e. Any Cause Whatsoever Beyond the Lessee's Reasonable Control

[544] The Plaintiffs refer to *Atlantic Paper Stock Ltd v St Anne-Nackawic Pulp & Paper Co*, [1976] 1 SCR 580, for the proposition that no economic concept should be read into the language of the third provisos referring to "any cause whatsoever beyond the Lessee's reasonable control".

[545] *Atlantic Paper* involved the interpretation of a contract between Atlantic Paper and St. Anne, whereby St. Anne agreed to purchase waste paper from Atlantic Paper in a specific amount to be used in the manufacture of corrugating medium. St. Anne sought to stop purchasing the waste paper on the basis that markets for corrugating medium had ceased to be available, relying on a clause of the contract pursuant to which St. Anne represented that it required not less than specified amounts of the waste paper:

> ... unless as a result of an act of God, the Queen's or public enemies, war, the authority of the law, labour unrest or strikes, the destruction of or damage to production facilities, or the nonavailability of markets for pulp or corrugating medium.

[546] The Supreme Court referred to this clause as an "act of God clause or force majeure clause" and noted that it was within such clause that the words "nonavailability of markets" were found. The Court noted that these clauses generally operate to discharge a contracting party "when a supervening, sometimes supernatural event beyond control of either party, makes performance impossible": para 4. The Court referred to the type of frustrating events listed in the clause, *being an act of God, the Queen's or public enemies, war, etc*. and commented that, reading the clause *ejusdem generis*, the nonavailability of markets as a discharging condition must be limited to an event over which St. Anne exercised no control: para 4.

[547] The Court then found that the primary cause of the lack of market was St. Anne's lack of an effective marketing plan, and that St. Anne had through bad planning priced itself out of any available existing market. Justice Dickson thus commented that St. Anne could not rely upon a condition which it brought upon itself. The Court overturned the decision of the New Brunswick Court of Appeal in favour of St. Anne, which it found would have had the effect of relieving St. Anne of a contractual obligation if it could not operate at a profit: para 6.

[548] The Plaintiffs submit that the Third Proviso clauses at issue in this case are similar to the kind of clause analyzed in *Atlantic Paper*, in that they are "force majeure" type clauses and should thus be interpreted very narrowly.

[549] The clause at issue in *Atlantic Paper* was very different in language and contractual purpose from the Third Proviso clauses at issue here. The language "any cause whatsoever beyond the lessee's reasonable control" is not preceded by a list of "supernatural events beyond the control of either party" as the words in issue in *Atlantic Paper* were, nor is the interpretation of this language a question of frustration of the contract.

[550] Reading the words at issue *ejudem generis* as the Court did in *Atlantic Paper* does not give rise to a suggestion that the language of the Third Proviso is force majeure language. In fact, the Union NE/4 Lease contains a specific Force Majeure clause that includes the type of act of God language referred to *Atlantic Paper*. That clause also includes reference to "any cause whatsoever beyond the reasonable control of the lessee" but that phrase is included as one of a list of act of God - type events, and in the context of whether the Lessee should be deemed to be in default of the performance of its contractual obligations. It is clear that there is no contractual obligation under the leases for the Defendants to continue producing beyond the primary terms and the habendum and third proviso clauses refer instead to a right to continue the leases either by production or by reliance upon an exception to the necessity of continued production.

[551] While the Alberta Court of Appeal applied *Atlantic Paper* in *Wal-Mart Canada Corp v Gerard Developments Ltd*, 2010 ABCA 149, this was again with respect to a specific force majeure clause. In that case, the appellants were required to construct a road by a specific deadline. The force majeure clause set out instances where failure to construct the road by a specific deadline would not be considered a breach of the contract. The Appellants relied on certain events as constituting force majeure, but the trial judge found that they could have met the deadlines had they exercised more diligence. It is noteworthy that both in *Atlantic Paper* and *Wal-Mart*, the Court in essence considered whether the events that were sought to establish force majeure were in actual fact events that were beyond the appellant's control, not whether acts of God made performance impossible.

[552] The Plaintiffs also cite the American decision of *Hydrocarbon Management Inc v Tracker Exploration Inc* for the proposition that third proviso clauses have been referred to as force majeure in nature in the United States: (1993), 861 SW 2d 427 at paras 20 and 21. That case also dealt with a specific force majeure clause, rather than the habendum and proviso clauses at issue here. While the case is thus distinguishable, the Court found that the event sought to trigger the relief of the force majeure clauses, a well being shut-in by the authorities due to overproduction, was an event within the reasonable control of the appellants. It should be noted that the *Hydrocarbon* case's interpretation of "production in paying quantities" was rejected by the ERCB in its decision in *Omers* on the basis that it was not an interpretation well-established in the industry or under Canadian law.

[553] I am thus satisfied that it is not necessary to interpret the phrase "any cause whatsoever beyond the Lessee's reasonable control" in such a manner as to restrict it to events of an "act of God" or "supervening sometimes supernatural" nature that make performance impossible. The Third Proviso language is not a true force majeure provision, and there is no reason to imply the limitations suggested by the Plaintiffs. No absurdity arises in giving the phrase its ordinary meaning.

[554] The Plaintiffs also submit that events that were foreseeable by the parties at the time of entering into the leases do not fall within the meaning of the wording"any cause whatsoever beyond the Lessee's reasonable control", citing *Canada-Cities Service Petroleum Corp v Kininmonth* (1963), 42 DLR (2d) 56 (Alta SC(AD)); aff'd [1964] SCR 439.

[555] The lease in *Canada-Cities* contained a third proviso that specified that the time of a suspension would not be counted against the lessee if such suspension was the result of any cause whatsoever beyond the lessee's control other than the lessee's lack of funds.

[556] The ten year primary term of the lease expired on May 10, 1961. The lessee commenced the process of drilling a well in late February 1961, which resulted in a dry hole. The lessee applied for permission to plug the well back to a possible productive zone, and in early April, 1961 the conservation board refused such permission until the lessee could establish that it had the right to produce from the entire spacing unit. Work was done to prepare the well for production, but prior to actual production, the well was shut-in between March 31 and May 23, 1961 as a result of a road ban imposed by the local municipality. There was evidence presented at trial to the effect that, upon application, a councillor of the municipality could issue, and had issued on at least one occasion, a permit to an applicant to use the road despite the ban, on the condition that the user would pay for any damage caused to the road. The lessee also attempted in August 1961 to obtain an order allowing it to continue producing from the well despite its failure to obtain control of a full spacing unit. This application ultimately failed. The lessee submitted that production under the lease was interrupted as a result of two causes beyond its control, the road ban and the order of the conservation board.

[557] In a highly divided decision, two judges of the Alberta Supreme Court, Appellate Division found that for a lessee to rely on a municipal road ban as a cause beyond its control, it was necessary that the road ban be valid. As it was not, and in any case a permit would have been issued to the lessee had it applied for one, the Court found that it could not be said that the suspension or interruption was the result of a cause beyond the lessee's control. The Court noted that, furthermore, the seasonal closing of roads should have been anticipated, and noted that the lessee had delayed drilling until just before the lease was to expire and commenced drilling just before spring thaw. As Porter, J.A. said in concurring reasons, "the coming of a road ban in this country is as certain as the coming of spring": para 71.

[558] It cannot be said that a drastic down-turn in the price of gas and accompanying high processing costs caused by external forces, the two factors relied upon by the Defendants in this case, are as inevitable or foreseeable as seasonal road bans, nor could a court "take judicial

notice of' such factors, as the Court in *Canada-Cities* did with respect to road bans in spring: para 7.

[559] The Plaintiffs further submit that the Defendants' proposed interpretation of "any cause whatsoever beyond the Lessee's reasonable control" would reallocate the business risk of an unprofitable market to the freeholder lessors by allowing the Lessees to hold the leases indefinitely based on their internal rates and the profitability of their oil and gas operations. The Defendants do not suggest that an interpretation of the Third Proviso language should depend on the particular hurdle rates of the Defendants. They have adduced expert evidence to establish that the 7-25 Well would not have been profitable to produce during the shut-in period from the perspective of a prudent operator, a more objective standard.

f. Have the Defendants Met their Onus?

[560] The next step in the analysis is to consider whether the Defendants have met their onus of establishing that the causes they assert led to the suspension of production from the 7-25 Well fall within the meaning of the ameliorating language of the Third Provisos of the leases in question.

[561] The Defendants submit that the 7-25 Well was shut-in because production was uneconomical at then-current gas prices and the higher processing costs attributable to that well. In support of that submission, they rely on the evidence of Mr. Seredynski, Mr. Watson and the opinion of Mr. Seth.

[562] They point out that the operator of the 7-25 Well recognized in 1982 that a better alternative for the well would have been to re-route the gas to the Petrogas Plant, which had greater capacity to take the well's production at lower processing costs and a better marketing situation with TransCanada. The working interest holders agreed that an application to accomplish this should be pursued, and CanOxy applied for a permit, but the Defendants submit that this alternative was thwarted by the ERCB. The operator was given the clear message by the ERCB that pursuing the application would give rise to an open hearing on the Petrogas Plant. The likely outcome of such a hearing, given the plant's proximity to Calgary, would be that the Petrogas Plant and gathering system would be shut-down.

[563] The Plaintiffs submit that the decision not to proceed with the application raises issues of conflict, given the operator's economic interests, but I am satisfied that the outcome would have been the same for any operator of the well. I accept Mr. Watson's testimony that proceeding with the application would have put the entire Petrogas Plant in jeopardy, and thus there would have been no benefit for the 7-25 Well.

[564] I am satisfied from the evidence that the Lessees through their agent, the well operator, made re-occuring attempts to deal with Amoco and obtain better processing terms for the 7-25 Well, to no avail. It is clear that Amoco was putting hurdles in their path for competitive reasons, but the Lessees through their operator made every reasonable effort to obtain processing capacity at the TAQA Plant. After 1987, there were no longer significant capacity issues at the TAQA

Plant but I am satisfied from the evidence that after that there were marketing and production constraints on the well.

[565] The Plaintiffs submit that, even if the leases are interpreted to include in the language of the ameliorating provisions the concept of an economical or profitable market, the Defendants have failed to meet their onus of establishing that the 7-25 Well was uneconomical or unprofitable during the shut-in period.

[566] Guidance on this issue can be obtained from the *Freyberg* Liability Decision. At paras 72 and 73, the Court commented:

> The issue of well economics can only be analysed prospectively. That is because economics is at least as much an art as it is a science. The test to be applied is whether, based on information available at the time, a prudent lessee would have foreseen profitability. A prudent lessee is to be defined on an objective standard influenced by (1) the character and nature of the lessee, and (2) the reasonable expectations of the parties. ...The reasonable expectations of the parties also forms a component of this objective standard ...
>
> In determining whether a prudent lessee would have objectively foreseen profitability, the view of the operator may be an important factor. However, while an operator's view of profitability may be influential it is not determinative as it is ultimately the reasonable view of the lessee that is the focus of the enquiry.

[567] For reasons I have already given, I accept Mr. Seth's opinion that the 1995 shut-in of the 7-25 Well was justified and appropriate. I accept that the decision to shut-in the well was commercially prudent, given that:

a) cumulative cash flow from the well was negative and it was producing at a loss;
b) estimates of remaining Crossfield formation reserves were minimal;
c) the price of gas was low; and
d) The net price of sulphur was negative.

[568] Thus, I accept that the 7-25 Well was shut-in in July, 1995 for causes beyond the Lessees' reasonable control, in that it was uneconomical to produce during the shut-in period given the low price of gas and the relatively high costs of production and processing, effectively a lack of an economic market. While the operator did not notify the other working interest owners of the decision to shut-in the well, as that decision was within its authority as operator, the other lessees did not object, implying that they were in agreement with the operator's decision.

[569] The question remains whether circumstances changed during the shut-in period such that a prudent operator would have foreseen profitability and taken steps to produce from the 7-25 Well, and when that change occurred.

[570] For reasons I have already given, I accept Mr. Seth's opinion that the reactivation of the 7-25 Well during the shut-in period was never economical, and that it would not have been commercially prudent to consider taking steps to recomplete the BQ formation until the second or third quarter of the year 2000.

[571] As set out in the *Freyberg* Liability Decision at paras 64 and 68, once the ameliorating provision has been established and the delay rental has been paid, the lease extends for a further one year period. At any rate, in November 2000, Triquest circulated an Independent Operations Notice to the other working interest owners and the 7-25 Well was put back on production in early 2001.

[572] The Plaintiff submits that the operator did not determine the price of gas at which it would have been economical to reactivate the 7-25 Well, and thus did not meet the standard of a prudent operator. Mr. Seredynski, however, testified that, while he did not run a full formal economic run, his group would have looked at suspended wells during the shut-in period to see if there were changed conditions significant enough to bring the well back on production.

[573] The Plaintiffs submit that in determining what constitutes an economical or profitable market, guidance should be gleaned from American cases that have considered the requirement to produce "in paying quantities," citing *Pray v Premier Petroleum Inc,* 662 P 2d 255 (Kan 1983).

[574] The Court in *Pray* started from the proposition under U.S. law that a shut-in royalty clause in an oil and gas lease enables the lessee under appropriate circumstances to keep a non-producing lease in force by the payment of shut-in royalties, a proposition that is not necessarily valid under Canadian law. The Court then noted that for the shut-in royalty clause to be operative, the shut-in well had to be capable of producing "in paying quantities".

[575] The term "in paying quantities" did not actually appear in the lease in question in the *Pray* decision, but was "implicitly a part of the habendum clause" under American law: para 1. In *Omers*, the ERCB refused to read "paying quantities" into the lease in that case, in part because it was not an interpretation that was well-established in the industry or under Canadian law: para 72. The ERCB's decision in that regard was adopted by the Court.

[576] Thus the analysis in *Pray* related to a question that was quite different from the issue before the Court in this case, and adopted a line of jurisprudence that was specifically rejected by the ERCB and the Court of Appeal in Alberta. It is thus not useful in interpreting issues of a profitable market in this case.

[577] For the purpose of determining whether a prudent operator would forsee profitability, the commercial realities of the natural gas industry must be taken into account, as they would be taken into account by a prudent lessee and operator.

[578] Both Mr. Seth and Mr. Six agreed, that in scenarios such as the one involving the 7-25 Well where capital was needed to recomplete a well, a producer would normally be looking for

attractive or acceptable returns, "hurdle rates", before proceeding. They differed on what hurdle rates were typically used by the industry at the time of shut-in, and, for the reasons I have given, I prefer the opinion of Mr. Seth.

g. *Conclusion on Lease Validity*

[579] The Defendants have met their onus of establishing on a balance of probabilities that the 7-25 Well was shut-in for reasons that fell within the ameliorating provisions of the Third Provisos of the leases, and the leases thus did not terminate as a result of the lack of production from August 1995 until January 20, 2001.

V. DAMAGES

[580] In the event I am in error in finding the leases did not terminate in accordance with their terms, I will address the issue of measure of damages.

[581] The Plaintiffs seek damages against the Defendants on the basis of the disgorgement of the gross proceeds of the sale of production from 2001 through 2011 in the aggregate amount of $31,502,196. In the alternative, they seek disgorgement in the amount of net operating income of $23,604,201.71.

[582] The Defendants submit that if damages are to be awarded, the appropriate measure of damages would be a level of royalty plus any applicable bonus that a lessee would have been required to pay at the time the existing leases terminated.

A. General Principles

[583] The Plaintiffs in seeking disgorgement are invoking the inaptly-named "waiver of tort" doctrine of restitution. As described in Peter D Maddaugh & John D McCamus, *The Law of Restitution*, loose-leaf, (Toronto, Ont: Canada Law Book, 2013) at 24-1:

> ... the concept is really quite simple: in certain situations, where a tort has been committed, it may be to the plaintiff's advantage to seek recovery of an unjust enrichment accruing to the defendant rather than normal tort damages.

[584] The torts complained of by the Plaintiffs are conversion and trespass. Given that the 7-25 Well is located on the Scurry SE/4 Lease, the tort of trespass is not available to the Plaintiffs unless I am incorrect in my determination that the Plaintiffs are unable to establish that the Jerome Group Plaintiffs are the proper parties entitled to seek a declaration that the Scurry NE/4 Lease and the Scurry SE/4 Lease have terminated. In fact, even if I am incorrect, and the Scurry SE/4 Lease is found to have terminated, trespass may still not be available, as noted by Professor Nigel Bankes in "Termination of an Oil and Gas Lease, Covenants as to Title, and Assessment of Damage for Wrongful Severance of Natural Resources: A Comment on Williston Wildcatters" (2005) 68:1 Sask L Rev 23 at 52. Professor Bankes suggests that an oil and gas lease may be analogous to a conventional lease in that an overholding tenant does not commit trespass.

[585] The Defendants submit that conversion is also not available, citing *Xerex Exploration Ltd v Petro-Canada,* 2005 ABCA 224, where the Court of Appeal described as "unsettled" the issue of whether the holder of a mineral rights license who has not yet exploited his interest has the immediate right to possession ordinarily required by the tort of conversion to substances that have not yet been severed from the ground.

[586] Be that as it may, I agree with Professor David R. Percy, Q.C. and David McGillivray in their article "Overlapping Remedies and the Unexpected Termination of Oil and Gas Leases" (2011) 49:2 Alta L Rev 251 at 263 that an energy company that extracts resources from land owned by another without a valid lease violates a property right of that person, and a remedy must be found.

[587] Restitution can form the basis for that remedy, and uncertainty as to the appropriate underlying tort is perhaps another reason why the modern law of restitution is moving towards the recognition that it is not necessary to establish an actionable tort in order to invoke the doctrine of waiver of tort, which can be considered an independent cause of action: *The Law of Restitution* at 24-21.

[588] The concept of unjust enrichment is at the heart of restitution, as recognized by the American Law Institute's *Restatement of the Law of Restitution: Quasi-Contracts and Constructive Trusts,* (St Paul: American Law Institute Publishers, 1937) at s 1 ("*Restatement*"), and, as noted by Justice Cromwell in *Kerr v Baranov*, "[a]t the heart of the doctrine of unjust enrichment lies the notion of restoring a benefit which justice does not permit one to retain": 2011 SCC 10, [2011] 1 SCR 269 at para 31.

[589] In the same vein, in an earlier case, Lord Wright stated that the objective of unjust enrichment is "to prevent a man from retaining the money of or some benefit derived from another which it is against conscience that he should keep": *Fibrosa Spolka Akcyjna v Fairbairn Lawson Combe Barbour Ltd,* [1943] AC 32 (HL) at 61. The authors of *The Law of Restitution* refer to the two rationales underlying the unjust enrichment doctrine at page 3-3:

> If the principal rationale underlying the unjust enrichment doctrine is that it is unjust to receive a windfall benefit at the plaintiff's expense, it must be emphasized that there is a second rationale of equivalent importance underlying the granting of relief in many restitution cases. There are substantial areas of restitutionary doctrine in which the reasoning of the courts manifests a predominant concern with the wrongfulness of the conduct of the defendant which has resulted in the acquisition of the benefit in question. The fundamental notion underlying the granting of recovery in such cases appears to be that "a person shall not be permitted to profit from his or her own wrongdoing". The granting of relief on this basis may be justified either on the ground that the conscience of the court is offended by the retention of the ill-gotten gain or on the instrumental ground that the granting of relief will act as a disincentive to such wrongdoing on future occasions.

[590] They point out that, while both rationales are present in many cases, that is not invariably so, and that wrongful conduct is not necessarily an element in establishing grounds for restitutionary relief: *The Law of Restitution, supra* at pages 3-4 and 3-7. However that does not mean that the restitutionary relief granted will not vary with the circumstances of the case. As noted by the Ontario Court of Appeal in *International Corona Resources Ltd v Lac Minerals Ltd* in explaining why, while granting a constructive trust in property to International Corona, they allowed LAC a lien on the property on the basis of improvements made:

> The proprietary remedy of restitution is one that enables the court to refuse full restitution or to relieve the constructive trustee from full liability where to refrain from doing so would, in all the circumstances, be inequitable. The sheer magnitude of the enrichment of, or the benefit conferred on, Corona, if LAC were denied a lien cannot be ignored, particularly in the light of the reality that the expenditures made by LAC to make the property productive inevitably would have been required on the part of Corona had there been no breach of the constructive trust. The principles of equity, in our view, need not be employed in a manner that itself creates an unjust enrichment or disturbs the conscience of the Court: (1987), 44 DLR (4th) 592 at 661 (Ont CA), aff'd [1989] 2 SCR 574.

[591] These comments are important in this case, as the Plaintiffs in submitting that they are entitled to disgorgement of profits on the basis of the so-called "harsh rule", or alternatively on a moderately less severe form of the "mild rule", argue that this Court should not follow the royalty measure of damages awarded in *Montreal Trust Co v Williston Wildcatters Corp*, 2004 SKCA 116, leave denied, [2004] SCCA No 474 and the *Freyberg* Damages Decision.

B. The Substitutionary Royalty Cases

a. Williston Wildcatters

[592] In a previous decision on lease validity involving Williston Wildcatters, the trial judge and the Court of Appeal held that an oil and gas lease had terminated in accordance with its terms. In the decision on remedy, Chief Justice Gerein, the trial judge, made findings on the issue of "leave and licence", which will be discussed later in this decision, and held that damages arising from the termination should be assessed on the basis of the amount of royalty and bonus payment that the trustee for the lessors would have received had the parties negotiated a new lease: 2003 SKQB 360. The Court of Appeal substantially agreed, but on a sightly different basis. Both courts rejected the suggestion that damages should be calculated on the basis of the market value of production minus certain deductions for costs incurred by Williston. They took the view that the royalty method was appropriate because the lessee was not a fraudulent or wilful trespasser and the trustee for the lessors could not have developed the property itself.

[593] The Court of Appeal began its analysis on damages with an explanation of the harsher and milder rules of damages arising from trespass. It cited the decision of Lord Blackburn in *Livingstone v Rawyards Coal Co* (1880), 5 App Cas 25 (HL (SC), including his statement at p 39 that the general rule is:

> ... where any injury is to be compensated by damages, in settling the sum of money to be given for reparation of damages you should as nearly as possible get at that sum of money which will put the party who has been injured, or who has suffered, in the same position as he would have been in if he had not sustained the wrong for which he is now getting his compensation or reparation.

[594] In *Livingstone*, the plaintiff owned a very small piece of land. He mistakenly believed that the coal under his land was reserved to the owner of the surrounding lands. He did not have the means to develop the land himself due to its small size. The defendant had leased the right to mine coal under the neigbouring land, and mistakenly believed it had the right to mine the coal under the plaintiff's land. When the mistakes were discovered and the plaintiff sued in trespass, the plaintiff received the equivalent of a royalty that others were receiving from the defendant for the surrounding lands, on the basis that the plaintiff could not and would not have worked the coal himself. Lord Blackburn decided that to follow the "milder" rule of awarding the sale value of the coal less the costs of mining and transporting it would be an error, as it would give the plaintiff a windfall.

[595] In *Williston Wildcatters*, Justice Vancise for the Court of Appeal commented that "the aim of the courts was to do equity between the parties". He characterized the harsh rule and the mild rule as merely expressions of that equity, and stated that "[t]he facts of the case should drive the result, not blind adherence to rules that create unjust results": para 87.

[596] He commented as follows at para 79-80:

> As the cases demonstrate, the "harsh" rule generally allows for the value of the material, be it coal, trees, etc., with only a deduction for transport of the materials to market, not the cost of severing the thing and putting it into a saleable state. This rule is generally used in a punitive manner where the trespasser takes a course of action with knowledge that they are committing a wrong, or where the conduct is sufficiently negligent or reprehensible that it warrants such treatment.
>
> The "mild" rule, on the other hand, is used where innocent trespass has occurred, where the trespasser believes that it is committing no wrong, or where there is no *mala fides* or other questionable conduct. The rule is *generally* that the damages are the value of the thing taken minus costs for severance, production and marketing, with no allowance for profit to the trespasser. However, there is an exception to this rule. Where it is proven that the claimant could not or would not have taken the resource or other valuable thing and put it in a saleable state, the best evidence of the loss to the claimant is the royalty that the claimant would have received had there been an agreement to do what was done *(Livingstone)*. This is included *within* the "milder" rule, and is a reflection of the overall goal of damages in this context: to put the plaintiff in the position he would have been in had the wrong not occurred.

[597] In response to the appellant's argument that the Supreme Court decision in *Weyburn Security Co v Sohio Petroleum Co* governed, and that it mandated an award of damages equal at least to the value of production sold less the cost of production and marketing, the Court analyzed *Sohio*: (1969), [1970] 7 DLR (3d) 277 at 283 (Sask CA), aff'd [1971] SCR 81.

[598] Justice Vancise found the facts of *Sohio* to be "remarkably similar" to the facts before him. *Sohio* had produced from a property for a number of years on the basis of a lease that was subsequently found to be invalid. It only had notice that the lessor was contesting the lease when served with a Statement of Claim seven years after production had commenced. The Court of Appeal in *Sohio* noted at 283:

> *Sohio* proceeded under a mistake as to its rights, and did not knowingly take an unfair advantage of the appellant's lack of appreciation of its legal rights ... Under the circumstances, it would appear just and equitable to order the respondents to account for all benefits from production received by them after the date of service of the writ of summons upon them.

[599] The decision was upheld by the Supreme Court without further comment.

[600] Justice Vancise pointed out that *Sohio* was not ordered to account for all production from the well less the cost of production but only to account for production received after service of the Statement of Claim. The Court in *Sohio* noted that no accounting was required for production prior to that, and noted that at that point, Sohio had received more from production than it had invested in the well: *Williston Wildcatters* at para 98.

[601] Justice Vancise commented at para 102 that the Court in *Sohio* did not deal with the "harsh" or "milder" rules, but, "put in that framework", it did apply a form of the "milder" rule. He speculated that perhaps the Court had applied the *Livingstone* rule, but that at any rate, the decision was "just and equitable". He commented further:

> This is not to say that it is an error of law to find that in another case a royalty should be used to calculate damages, just as in *Livingstone*. At its highest, *Sohio* is consistent with the law as developed in England and Canada and stands for the proposition that the courts are to grant just and equitable relief to *all* parties involved. To read more into *Sohio* would simply be incorrect.

[602] The Court then stated that the milder form of the rule is generally applied in Canada where the plaintiff had the ability to exploit the resource itself, but the defendant mistakenly did so. However, where the plaintiff could not exploit the resource itself, the market value of the resource minus the cost of mining and transportation measure of damages was inappropriate: para 103.

[603] He noted at para 105:

> ... This Court has the jurisdiction to adapt the damage award based on the facts of the particular case ... it is clear that in the present case, the appellant could not have produced oil from the land itself, and it should not receive any more than the royalty it would have gotten had it had a valid lease in place. Chief Justice Gerein's judgment reflects this reality.

[604] In response to the suggestion that this solution would encourage trespass, Vancise, J.A. commented as follows at para 110:

> The main objective in awarding a plaintiff damages is to put that plaintiff in the same position it would have been in had the wrong not occurred. This principle derives from equity and has as its goal doing justice and equity between all parties on the facts. (See *Sohio, Livingstone,* etc.) In the context of natural resources that are taken from land the courts have developed a method of determining the value of such natural resources. In the case of trespass, there is a punitive element to the damages which will be awarded that is reflected in the "harsher" rule as described in *Martin*. This rule is designed to deter wilful trespass. On the other hand, where the trespass is not tainted by fraud or bad faith, the punitive element is removed, and the trespasser "breaks even" with the plaintiff recovering what they would have had they harvested/extracted the resource and put it to sale. This prevents the plaintiff from receiving a windfall where it is not warranted. (See *Wood, Jegon,* etc.) There is a further refinement that where the plaintiff is a person who could not or would not extract or harvest the resource himself or itself, but would have procured a third party to do so, the damages awarded by the courts reflect only the royalty the plaintiff would have received for the exploitation of the resource. The reason for this is that if the plaintiff receives more it will receive what it could never have obtained. Although such refinement does give the trespasser the profit it would have received had they acted lawfully, such result is justified by reason of the lack of bad faith or the mistaken belief that they were acting lawfully, and it is preferable to giving the plaintiff a windfall profit in such circumstances. Arguments that suggest that this will encourage trespassers to be careless as to whether they act legally or not should be instantly quelled: a trespasser who does so is almost certain to fall under the harsher head of damage due to their negligence or bad faith, and thus this option of damages is not even open to the court. (emphasis added)

b. Freyberg Damages Decision

[605] This decision was, like the previous one, the result of a subsequent trial on damages after a lease had been found to be invalid. The plaintiff, Lady Freyberg, claimed damages on a restitutionary basis to be calculated under the "harsh" rule, alleging trespass and conversion.

[606] Justice Kent proceeded on the basis that Lady Freyberg's case was based on the tort of conversion. The defendants had the right to take the gas of one of the unit lessors that had not

contested its lease, and the right to enter onto the lands by virtue of a surface lease. Thus, trespass was not available to Lady Freyberg.

[607] Justice Kent described her understanding of the "harsh" rule and the "mild" rule of measure of damages in restitution, and then commented at para 100 as follows:

> The second approach awards damages on a compensatory basis. It does not focus on stripping the benefit of a trespass away from a wrongdoer, but rather on placing the plaintiff back into the position he or she would have been in but for the commission of the tort. Under this approach, in a case such as this, it may be that the plaintiff receives damages equivalent to the substance converted less the costs of production (the mild rule in the restitutionary approach) or something less. It depends upon the facts.

[608] After a review of cases where damages were assessed in accordance with restitutionary principles, including *Livingstone*, Kent, J. focussed on *Williston Wildcatters*. She noted that Lady Freyberg sought to distinguish *Williston Wildcatters* on a number of grounds, including that, unlike the trustee in that case, Lady Freyberg had the right to do anything with her minerals, and that at least some of the defendants were guilty of misrepresentation, arrogance, abuse, bad faith and negligence. Lady Freyberg argued that, unlike in *Williston Wildcatters*, where none of the parties realized that the lease was no longer valid, there was overwhelming evidence that the lease had terminated: para 130.

[609] Justice Kent found that the compensatory approach was the appropriate approach to damages, noting that "[t]o make an award that focuses on the [defendants'] conduct requires that I find conduct that was sufficiently reprehensible to ignore the possibility that Lady Freyberg would be overcompensated". She found no such conduct: para 131.

[610] While the conduct of one witness was "reprehensible", this conduct could not be attributed to the defendants in general. The conduct of the defendants during the litigation in maintaining that the lease was valid "simply accorded with their belief ... and nothing more": para. 131.

[611] With respect to the issue of whether Lady Freyberg would have produced the well on her own, Kent, J. found that there were "too many institutional barriers to [her] operating this well herself either personally or, through a corporation, even with an experienced contract operator to do the work."

[612] In conclusion, Kent, J. found that, although a royalty and bonus award would be appropriate, she did not have sufficient evidence to decide on a royalty percentage. She set the issue over for a further hearing. The decision was not appealed, and there was no further hearing as the parties reached a settlement.

C. Analysis

[613] The Plaintiffs submit that I should not follow the approach taken in the *Williston Wildcatters* and *Freyberg* Damages Decision, for three reasons:

a) these cases have been widely criticized by academic writers;
b) they can be distinguished on the basis that the Defendants in this case are not innocent tortfeasors; and
c) they can be distinguished on the basis of the involvement of FSI and 108.

a. Criticism of the Royalty Approach

[614] It is true that Professor Bankes criticized the *Williston Wildcatters* decision in his previously cited 2005 article. However, he suggests at page 57 of the article, correctly in my view, that there is greater diversity in the case law than a simple division between the "harsh" rule and the "mild" rule, and that there are actually four lines of authority:

a) cases that provide an allowance for post-severance costs only (the "strict" approach);
b) cases that provide an allowance for both pre and post-severance costs;
c) cases that provide no allowance for costs (rare); and
d) cases that provide an allowance for costs - plus, including a profit to the tortfeasors (which in his view include *Sohio*, *Williston Wildcatters* and presumably *Freyberg,* which had not been decided at that time).

[615] Professor Bankes was of the opinion that the royalty cases were inconsistent with the bulk of authority. The article was written before the leave to appeal of *Williston Wildcatters* to the Supreme Court was denied, and Professor Bankes suggests that, if the decision was affirmed, "a truly exceptional line of authority will immediately become the norm".

[616] He suggests that the conflict in the case law should be resolved by allowing a plaintiff to make a gains-based claim to the value of the resource and further, that the tortfeaser should be able to make deductions for improvements that add value to the resource. This, he submits, abolishes the distinction between the strict and mild rules, which he suggests rests on the "indefensible" claim that intentions should be relevant to the assessment of damages for strict liability torts: at 57-58.

[617] I cannot agree that conduct-based distinctions are indefensible in determining measure of damages in restitution, even where the underlying tort may be one of strict liability. As noted by Professors Maddaugh and McCamus at page 3-3 of *The Law of Restitution*, one of the rationales underlying the granting of relief in restitution cases is a concern with wrongful conduct.

[618] It is the concept of unjust enrichment, and not just enrichment, that underpines this area of law, and the degree to which "the conscience of the court is offended by the retention of the ill-gotten gain" is surely a factor in the development of the law of restitutionary remedies.

[619] Professor Bankes explains that his recommendation is consistent with the strict nature of liability in conversion, as it does not distinguish between whether or not the defendant acted knowingly or in good or bad faith. In his view, these matters would be best left to consideration of punitive damages.

[620] He suggests that the no-deductions approach is inappropriate since it overcompensates a plaintiff who receives damages that exceed its actual loss, and the costs-plus approach is inappropriate since it allows the defendant to benefit from its wrong: at 75.

[621] Professor Bankes' article illustrates that the issue of measure of damages in cases of this kind is far from clear, and that a court's rationale for choosing one measure rather than another is often opaque and confusing. While his solution provides some degree of certainty, it fails to adequately deal with the role misconduct or the degree of misconduct has played in the development of the law of restitution, and how this factor must inevitably influence a court applying a doctrine that rests on the correction of injustice.

[622] It is noteworthy that Professor Bankes' suggested approach is not the one put forward by the Plaintiffs in this case, who argue for the "harsh rule".

[623] The Plaintiffs rely on an article presented at the Fifth Annual Conference on Student Publishing in Law, H. Michael Rosenberg, "When Gains Trump Losses: An Analysis of Restitutionary Relief for the Tort of Conversion" (2010) 68(1) UT Fac L Rev 39. Mr. Rosenberg argues that *Williston Wildcatters* and the *Freyberg* Damages Decision misstate the law of restitution. He approaches the issue from the fundamental premise that proprietary torts should be attributed special status, as a claim to property will survive the tort in question. He submits that, since the tort of conversion does not extinguish the property interest of the mineral rights owner, and the owner who falls victim to an act of conversion may follow her property, and if it has been sold, trace and claim the proceeds, which he describes as a "forward-looking remedy", she is entitled to the profits that were generated on sale. He notes, without citing authority, that "[r]estitution is not about recovering the thing that the plaintiff has lost, but, rather, the things that the owner's claim of right has become". This ignores the concern over unjust enrichment that led to the development of the "mild" rule.

[624] Mr. Rosenberg concedes that the harsh rule was designed to punish a wilful trespasser, but appears intent on limiting its variation to the mild rule, arguing that the availability of a restitutionary remedy does not depend on a defendant's mala fides: pg. 58. While this is true, it is also certainly true that the measure of damages in restitution varies with the degree of wrongful conduct.

[625] He comments that "[t]he restitutionary remedy restores the plaintiff to her position as one who owns property and is entitled to its value, come what may": at 48. In his analysis, Mr. Rosenberg appears to conflate the principles of the tort of conversion with a remedy in restitution. He rejects the concept that "value" should mean value to the plaintiff in the reality of existing circumstances, which is behind the reasoning of *Livingstone*. It is noteworthy that the

Plaintiffs in this case may not be able to establish the tort of conversion, and that their remedy, if the Leases were terminated, may rest in the independent cause of action of restitution.

[626] Mr. Rosenberg submits that *Livingstone* was wrongly decided, in that it does not correspond with his rights-based analysis based on property law, and that it thus follows that so were *Williston Wildcatters* and the *Freyberg* Damages Decision.

[627] He admits that *Sohio* is "subject to misinterpretation", but would prefer to view that case as "a pragmatic application of the mild rule of restitutionary damages". While it may be said that the plaintiff in Sohio received "something akin to disgorgement" of the defendant's profits, that "something" was more than it would have recovered under any then-iteration of the "mild" rule.

[628] It is difficult to see why Vancise, J.A. in *Williston Wildcatters* was not correct in characterizing the Supreme Court's decision in *Sohio* as standing for the proposition that "the courts are to grant just and equitable relief to all parties involved": *Williston Wildcatters* at para 102.

[629] One of the interesting comments in the Rosenberg article is found in a footnote: note 69 at 75. Mr. Rosenberg comments that, during the presentation of his article, Professor Edward Iacabucci observed that "in an efficient market, damages in tort and restitution will tend to converge when the restitutionary remedy is calculated properly". As he notes, this approach challenges the notion that the energy company has any profits to disgorge, when one accounts for the cost of capital and inherent risk. While this concept is unpalatable to Mr. Rosenberg, he does not address why it is unfair in the scenario where a mineral owner would never realistically be able to exploit the minerals herself, even with the aid of a contract operator.

[630] This concept of converging remedies makes sense in the context of the development of restitutionary law, where it was necessary to use restitutionary concepts in order to do justice between the parties and where ordinary damages were inadequately or unsatisfactory. There is no support in the case-law for the idea that the purpose of restitutionary remedies is to give either party a "singular stroke of luck" or a "windfall" not earned by its efforts, at least where the defendant acts in good faith under a mistake of fact or law.

[631] Professor Percy and Mr. McGillivray provide an analysis that helps to explain the conflicting lines of authority and opinion on this issue in their previously-cited 2011 article. They consider and discuss the objections to and criticisms of the royalty approach levied by Professor Bankes and Mr. Ballem, and largely do not disagree with them. They also raise the concern that the denial of a restitutionary remedy in *Williston Wildcatters* and the *Freyberg* Damages Decision on grounds that its result would be excessively generous is contrary to the normal approach when overlapping remedies are available in a particular case. They suggest that this treats restitution as a guide to the quantification of damages, rather than an independent cause of action: at 271.

[632] However, they argue that the critics of these two cases "go a step too far in arguing that the normal consequence of applying the restitutionary approach involve the recovery of some measure of the proceeds of production": at 272.

[633] As they note, the law of restitution has developed rapidly in recent years, and assumptions from previous cases may no longer represent the modern law in this area.

[634] Professor Percy and Mr. McGillvray draw a distinction between restitutionary damages, which are designed to reverse a wrongful transfer of value from the plaintiff to the defendant, and disgorgement damages, which require the surrender of profits resulting from the wrong. They note that disgorgement is an unusual remedy in the field of civil remedies, and equally rare in unjust enrichment. They suggest that it is simply not the case that a tortfeasor is never permitted to profit from a wrong.

[635] The article refers to the Supreme Court's comment in *Strother v 3464920 Canada Inc*, 2007 SCC 24, [2007] 2 SCR 177 at para 77 that:

> ... disgorgement is imposed to serve a prophylactic purpose, the relevant causation is the breach of a fiduciary duty and the defendant's gain (not the plaintiff's loss). Denying [the wrongdoer] profit generated by the financial interest that constituted his conflict teaches faithless fiduciaries that conflicts of interest do not pay.

[636] If the inquiry in a claim for restitution involves an examination of the value transferred from the lessor to the lessee when the lease came to an end, then it is not an error to look at the reality of what the lessor has lost. If that loss can only in the plaintiff's circumstances be characterized as the loss of an opportunity to re-lease the property to either the defendant or another lessee at the bonus and royalty rate that would have been payable at the time the lease terminated, that may be an appropriate measure of damages, whether using principles of restitution or compensatory principles. If the circumstances of the situation require more punitive measures, because the behaviour "offends the conscience of the court' or because relief needs to act as a deterrent to such wrongdoing on future occasions, those measures may include disgorgement of profit.

[637] This analysis, that disgorgement of profit is but one tool in the discretionary range of measure of damages available to a court in claims for restitution, does much to reconcile the diverse and inconsistent results of previous cases. It also brings to mind the comments of Lord Nicholls in *AG v Blake*, [2001] 1 AC 268 at 278 as follows:

> Damages are measured by the plaintiff's loss, not the defendant's gain. But the common law, pragmatic as ever, has long recognised that there are many commonplace situations where a strict application this principle would not do justice between the parties. Then compensation for the wrong done to the plaintiff is measured by a different yardstick. A trespasser who enters another's land may cause the landowner no financial loss. In such a case damages are measured by

> the benefit received by the trespasser, namely, by his use of the land. The same principle is applied where the wrong consists of use of another's land for depositing waste, or by using a path across the land or using passages in an underground mine. In this type of case the damages recoverable will be, in short, the price a reasonable person would pay for the right of user. (emphasis added)

[638] Lord Nicholls also noted in that case that it is only in cases where less drastic remedies are inadequate that an accounting of profits should be awarded, noting that "(a) useful general guide, although not exhaustive, is whether the plaintiff had a legitimate interest in preventing the defendant's profit-making activity and, hence, in depriving him of his profit": *Blake* at 287. While this was a case of contract and not tort-based restitution, it illustrates the concept that disgorgement is not the only remedy in the restitution tool-box.

[639] Even in property based cases, the remedy has not always been disgorgement. It can be, for instance, "a reasonable sum for the wrongful use ... of the other's property": *Stoke-on-Trent City Council v W & J Wass Ltd*, [1988] 1 WLR 1406 (CA) at 416.

[640] In so called "user principle" cases of restitution, rental value is described as "the most convenient and logical means for ascertaining what proportion of the benefits received may be attributed to the use of the real estate": *Edwards v Lee's Administrator*, 265 Ky 416 (CA) 1936 at 425.

[641] As the authors of *The Law of Restitution* comment, whether a plaintiff can go further than the "user-principle" of remedies and claim profits made by a defendant is "perhaps more difficult to justify": at 24-28. While claims for profits may well be justifiable on the basis of bad faith or reprehensible conduct, or when the plaintiff has lost an opportunity to use the land in the same manner as the tortfeasor, it is less so where a defendant is merely guilty of an accidental tort, and the loss is of a more limited opportunity.

[642] Professors Maddaugh and McCamus describe the American approach as follows at page 24-31 of *The Law of Restitution* as follows:

> Where the defendant is an innocent wrongdoer, the plaintiff's claim is limited to the reasonable value of the user. But where the wrongdoing is deliberate and intentional, the plaintiff is entitled to a maximum of restitution, including the profits derived thereby.

[643] I am of the view that the approach followed in *Williston Wildcatters* and the *Freyberg* Damages Decision would be open in this case if the leases had terminated and if the circumstances suggest it is appropriate, although the relief granted may still be characterized as a measure of damages in restitution.

b. Are the Defendants Innocent Tortfeasers?

[644] The Plaintiffs submit that the Defendants knew or ought to have known that the validity of the leases was subject to challenge as a consequence of the operator's decision to shut-in the 7-25 Well. Specifically, they rely on Mr. Thomsen's inquiries with respect to the validity of the leases in the summer of 2000. As Mr. Thomson testified, he was concerned about the shut-in period when he noticed that the well had not produced for a five year period. He noted, however, that he was merely relying on Accu-Map information and the wording of the lease. He said that his concerns were allayed when Mr. Aukema advised him that the well had been shut-in due to high fees that would make it uneconomical. He still had a "slight cloud" in his mind, but pointed out that he was not aware of any case law on the issue, and at any rate did not have the capacity to make a determination on lease validity. While he raised the issue again at the time of the Triquest re-work, he was comfortable with ExxonMobil's participation as he was of the opinion that the lease was in good standing. Mr. Morrice of Triquest did not recall Mr. Thomsen mentioning this issue, but said he had no concerns about lease validity.

[645] This testimony would not persuade me that the defendants or any of them knew or should have known that the Leases had terminated. All this evidence establishes is that a landman employed by one of the Defendants raised an issue about the validity of one of the leases on the basis of limited information, and his concerns were later alleviated.

[646] If the leases had terminated, they would have terminated in accordance with their terms, with no breach of contract involved. The fact that they had terminated would have been unknown to either party at the time it occurred. For a number of years, the Defendants may have innocently produced gas from the 7-25 Well, and the freeholder Plaintiffs, equally innocently, did not object.

[647] The Plaintiffs note that in late 2003, some of them wrote to ExxonMobil and Nexen with concerns about the validity of the leases. Both of these defendants responded that they were of the view that the leases were valid. In September 2005, the Defendants that had caveats registered were served with the Plaintiffs' Statement of Claim and Notices to Vacate. Other Defendants were served in later years.

[648] The case law is inconsistent with respect to whether continued occupation and production after the lessee receives notice that the validity of a lease is in issue is conduct that may justify the imposition of a "harsh" rule of damages.

[649] In cases where this appears to have been a factor, it was clear that the lessee should have known that the lease was invalid at that point in time. Here, the Defendants have maintained the validity of the leases, and it is clear that the issue was not clear-cut or certain one way or another. Even if I am incorrect, and th leases are invalid, the Defendants' conduct in maintaining their belief in the validity of the leases would not justify the imposition of the "harsh" rule. In particular, the absence of Snell Farms and Wheatland as parties to the litigation raises the issue of the Defendants' obligations to third-parties that may have been breached had they prematurely ceased production.

[650] In short, continued production after service of the Statement of Claim and Notice to Vacate did not constitute, in the circumstances of this case, wrongful conduct that would distinguish this case from *Williston Wildcatters* or the *Freyberg* Damages Decision or that would justify a harsher imposition of damages.

[651] The Plaintiffs appear to argue that the allegations of discriminatory production practices and failure to drill in the Elkton zone are relevant to the issue of damages, in that they are "essential to [the] Court's assessment of the bona fides of the lessee Defendants" and the proper measure of damages. They submit that the result of the alleged discriminatory production practices was to deprive the freeholder Plaintiffs of royalties on gas that was competitively drained by surrounding wells.

[652] I do not intend to address there allegations in detail, as they are barred by the ultimate limitation period, but, at any rate, these allegations were not proven by the evidence. If discriminatory production practices had been established, they would have preceded the alleged trespass and conversion in time, and cannot be relevant to measure of damages for these torts. I would not find on the evidence of the Defendants' witnesses any breach of good faith or discriminatory production that could justify the imposition of the harsh rule of disgorgement.

[653] The Plaintiffs submit that after the ruling of the Alberta Court of Appeal in February 2005 in the *Freyberg* Liability Decision to the effect that payment of delay rentals could not save a lease otherwise terminated, the Defendants should have known they had no colour of right to continue trespassing and converting the Plaintiffs' gas.

[654] While the Defendants may have asserted the payment of delay rentals as one reason that they considered the leases to be valid, they were not restricted to that argument and could, and obviously did, consider the leases valid for other reasons. Even if the leases had terminated, I would have found the Defendants to be innocent tortfeasors, and assessed damages on that basis.

c. Does the Involvement of FSI and 108 distinguish this case from Williston Wildcatters and Freyberg?

[655] The Plaintiffs submit that this case is different from *Williston Wildcatters* and the *Freyberg* Damages Decision, in that they have established that they would be able to operate the 7-25 Well on their own by entering into an arrangement with FSI and/or 108.

[656] In fact, the arrangements with FSI and 108 confirm that the freeholder Plaintiffs have no intention or ability to operate the 7-25 Well on their own, in that what they have entered into with FSI and 108 are top-leases on similar but financially enhanced terms as the ones entered into with the Defendants, and an arrangement to share 50% of any damages awarded in the litigation. This is not a situation where the Plaintiffs would direct the development of the property with the aid of a contract operator. It would be FSI and 108 that would do so, likely with the aid of a contract operator themselves. For the purposes of this analysis, I have assumed that FSI and/or 108 could operate the 7-25 Well, although if it were relevant, there appear to be material barriers to that eventuality. After sharing the damages obtained in the litigation, the

freeholder Plaintiffs would be in the same situation as before, lessors under an oil and gas lease entitled to royalties.

[657] Their future intentions are further clarified by the fact that, in January, 2012, on the eve of trial, the freeholder Plaintiffs, Mr. Bowes, certain companies controlled by Mr. Bowes, Mr. Erickson, 108 and FSI entered into a settlement agreement with the CrossAlta entities involved in the litigation pursuant to which CrossAlta alleged production of storage gas from the 7-25 Well. Under that litigation, the working interest owners of the 7-25 Well have made third-party claims against the freeholder Plaintiffs and the top-lessees, claiming repayment of royalties paid to them in respect of any storage gas produced.

[658] Under this settlement agreement, CrossAlta agreed to compensate the freeholder Plaintiffs and the top-lessees in an undisclosed amount with respect to their interests in Section 25 in return for the present value of freehold gas storage leases that the freeholder Plaintiffs entered into with CrossAlta (which were not produced at trial), and the assignment by the top-lessees of all of their interests in the top-leases, other than their right to prosecute and their right to retain the proceeds of this litigation, all contingent on a final determination as to the validity of the leases.

[659] Thus, despite the top-leases, the top-lessees would never produce gas from Section 25, and the issue of whether they are qualified to operate a well, or could overcome the barriers to production, is not relevant.

[660] As indicated in *Williston Wildcatters*, "where the plaintiff is a person who could not or would not extract ... the resource himself ... but would have procured a thirty party to do so, the damages awarded by the courts reflect only the royalty the plaintiff would have received for exploitation of the resource": para 110.

[661] The Saskatchewan Court of Appeal recognized that this may give an innocent trespasser the profit it would have received had it acted lawfully, but preferred that to giving the plaintiff a windfall profit. That concern is exacerbated in this case: profit would go, not only to the freeholder Plaintiffs, but would be shared with the top-lessee promoters of the litigation, third parties with no rights to the property other than those created by the top-leases, and now the CrossAlta settlement. Thus, parties with no current property or leasehold rights would receive a substantial windfall in return for funding and managing the litigation. There is no logical reason why the Plaintiffs should receive a higher damages award in the circumstances merely arising from the involvement of FSI and 108. This would be the "singular stoke of luck" referred to in *Livingstone* and *Williston Wildcatters*, accruing not only to the freeholder Plaintiffs, but to strangers to the claim.

D. Disposition

[662] Had I found the leases to be invalid, I would have found that the Defendants were innocent tortfeasors who acted in the mistaken belief that they were acting lawfully. Thus, the

options for damages in restitution would be either a form of the "mild" rule of disgorgement or the royalty approach adopted in *Williston Wildcatters* and the *Freyberg* Damages Decision.

[663] The reasons why a royalty approach in restitution would be appropriate are as follows:

a) The use the freeholder Plaintiffs intend to put the property to is a factor in determinating the appropriate measure of damages and it is clear that they lack the intention to exploit the property themselves, and the ability to do so. There is evidence in the form of the top-leases and the CrossAlta Settlement of what the freeholder Plaintiffs intentions are;

b) While this may result in profit for the Defendant tortfeasors, they did not act in bad faith, but with the mistaken belief that the leases were valid;

c) There is precedent for such an award, in *Sohio*, in *Livingstone*, in *Williston Wildcatters* and in the *Freyberg* Damages Decision;

d) Such an award would not encourage careless or cynical trespass or conversation since situations where that occurs can be deterred by the application of the remedy of disgorgement;

e) Disgorgement is a severe remedy that should only be applied when circumstances are such that more punitive measure are appropriate, or where the plaintiff has lost a realistic opportunity to use the property in the same manner as the innocent tortfeasor; and,

f) A royalty and bonus remedy can be structured that will ensure that the freeholder Plaintiffs are put in the same position they would have been had the wrong not occurred.

[664] The reasons why a disgorgement remedy in restitution would be appropriate are:

a) It is arguable that there is no logical reason why, between an innocent plaintiff and an innocent tortfeasor, any profit arising from the wrongful act should remain with the tortfeasor; and,

b) There must be adequate deterrence to prevent the deliberate or cynical commission of torts where to do so would profit a tortfeasor above any potential damages award.

[665] In this case, I would find a royalty and bonus approach to be the most appropriate, given the lack of any persuasive evidence of bad faith or cynical over-holding. I also would find it a factor that any profit awarded to the freeholder Plaintiffs would be shared with FSI and 108 as promoters of the litigation, with the result that there would be a windfall to a party with no present property rights or leasehold rights. I would find that there was no misconduct during the

litigation that would disentitle the Defendants from the application of the royalty and bonus approach, which would do justice between the parties.

[666] As was the case in the *Freyberg* Damages Decision, there was little evidence of what an appropriate bonus and royalty would have been, had the parties had the opportunity to negotiate it at whatever point in time that the leases would have been found to have terminated. As in that case, I would be required to direct further evidence.

E. Leave and License

[667] The issue of leave and license would only be relevant if I were to find trespass available to the Plaintiffs. If I am incorrect in the determination that trespass is not available, the general principles of *Williston Wildcatters* would apply. There would thus be no question of leave and license until the freeholder Plaintiffs came to the belief that the leases had terminated.

[668] Given the circumstances of the allegations of royalty overpayment and the correspondence and other communication that passed between the Oneil family and Nexen and ExxonMobil, I would not find that there was any leave and licence extended to the Defendants. However, I would find that the Irwin Group had implicitly given leave and license to Coastal from the time they entered into the top-leases in 2005 but continued to accept royalty payments until January 12, 2007, when they demanded that Coastal stop producing from the 7-25 Well.

VI. POSITION OF THE DEFENDANT ESPRIT

A. Overview

[669] While the Defendant Esprit advanced full defences to all the Plaintiffs' claims (including denying that the leases terminated and that the Defendants are liable in conversion, trespass and unjust enrichment), its closing argument addressed only those issues that are unique to Esprit.

[670] Esprit had limited involvement in the disputed events. Esprit never held a working interest in the Section 25 Lands at a time when oil and gas were being produced, from February 2001 to January 2011 (the "Production Period"). Esprit never produced, severed or sold oil or gas from the Section 25 Lands. Esprit's only meaningful involvement in the disputed events stems from the fact that it was the recipient of a 10% Gross Overriding Royalty ("GOR") payment from Bonavista, during this period, amounting to $1,660.481.92. In this capacity, Esprit was only one of thousands of payees who received payments from the four working interest owners (Bonavista, Coastal, ExxonMobil and Nexen). Esprit argues that if it can be found jointly and severally liable, so too can the many thousands of other payees, including shareholders who received dividends, employees who received wages, and the freehold royalty lessors who received royalty payments, including the Plaintiffs.

[671] Canadian 88, to which Esprit is the successor in interest, obtained an interest in the Section 25 Lands on August 1, 1995, one month after the 7-25 Well was suspended. Canadian 88

sold all of its interests in the BQ formation to Triquest effective May 1, 2000. Consideration included the 10% GOR payable first by Triquest, and then by Bonavista, its successor in interest.

[672] Esprit argues that it is not liable in conversion, as conversion involves the wrongful interference with, or usurption of, proprietary or possessory rights in the goods of another, in a manner inconsistent with the owner's right of possession. Esprit argues that according to the *Freyberg* Damages Decision, conversion occurs at the point of extraction in the oil and gas context. Consequently, it submits only the working interest owners may be liable in conversion.

[673] Esprit argues that it cannot be held liable jointly or severally for trespass or conversion. It again cites the *Freyberg* Damages Decision for the requirements for a finding of joint and several liability among working interest owners: (i) a wrongful act; (ii) mutually performed by the defendants; (iii) in futherance of a common purpose. In the *Freyberg,* Damages Decision, two minor working interest partners were not found jointly and severally liable because they did not accept gas or payment for gas marketed on their behalf. Esprit argues that since it is not a working interest owner and did not participate in any possible conversion of the Plaintiffs' petroleum substances, it has even less of an interest in and connection to the Section 25 Lands and cannot be found jointly and severally liable.

[674] Esprit argues that it was not unjustly enriched as it did not receive a benefit at the Plaintiffs' expense. Instead, Esprit argues the alleged deprivation of the Plaintiffs corresponds to the alleged enrichment of the working interest owners. To claim the same loss against both the working interests owners and other people who have received payments from the working interest owners would constitute impermissible double-counting.

[675] The Plaintiffs appear to base their claim against Esprit on the argument that, since the royalty in question is an interest in land, Esprit must be a party to a conversion, and must disgorge all of its royalty payments received during the Production Period. It notes that, under the agreement that established the royalty, Esprit had the option of taking its royalty share as gas. While it did not do so, the Plaintiffs submit that Bonavista acted as Esprit's agent in marketing Esprit's share of production, and thus, Esprit is liable for the torts committed by Bonavista.

B. Disposition

[676] If I am incorrect in my finding that the leases did not terminate and if damages other than a royalty basis were the ultimate result, I would find that there was an insufficient degree of proximity between the Plaintiffs and Esprit to impose liability for damages. Esprit had no control over the production of gas during the Production Period and exerted no influence over the other Defendants.

[677] While Esprit had a more significant connection to the production of gas on the Section 25 Lands than shareholders, employees and lessors, since it was a working interest owner from 1995 to 2000, the damages claimed in disgorgement relate to the Production Period after Esprit sold its interest.

[678] Esprit had had no involvement in the extraction of gas from the Section 25 Lands after it sold its interest to Triquest in 2000. Triquest took control of all operations without direction from Esprit. There is no evidence that Triquest, and later Bonavista was acting on behalf of Esprit in any kind of capacity. The mere fact that Esprit had an option to take its royalty in kind does not make Triquest or Bonavists its agent in circumstances when it did not do so.

[679] The *Freyberg* Damages Decision supports Esprit's position. It established that there needs to be some kind of collusion among various defendants in order to find a party jointly and severally liable for trespass or conversion. Kent, J. found that even minority working interest owners had an insufficient connection to the conversion to find joint and several liability. It is difficult to see how Esprit, having no connection to the production of gas during the Production Period, could be found to be colluding with the other working interest owners to perpetuate any conversion of the petroleum products from the Section 25 Lands.

VII. COUNTERCLAIMS

A. Champerty and Maintenance

[680] Nexen, ExxonMobil and Coastal assert a counter-claim in champerty and maintenance against 108 (in the case of Coastal), and 108 and Mr. Bowes (in the case of Nexxen and ExxonMobil).

[681] A person is guilty of maintenance if he supports litigation in which he has no legitimate concern without just cause or excuse: *Chitty on Contracts*, art 939. Maintenance is "confined to cases where a man improperly and for the purpose of stirring up litigation and strife, encourages others either to bring actions or to make defences where which they have no right to make: *Finden (Findean) v Parker* (1843), 11 M & W 675, 152 ER 976 at 970. Champerty is defined as a kind of maintenance in which the maintainor is entitled to a portion of the proceeds of the litigation as his reward for the maintenance: *Re Trepca Mines Ltd.,* [1963] Ch 199, cited in *Pioneer Machine (Rentals) Ltd v Aggregate Machinery Ltd* (1978), 93 DLR (3d) 726, [1978] 6 WWR 484 (Alta SC).

[682] It is certainly true that 108 is entitled to a portion of the proceeds of this litigation. The issue is whether 108 and Mr. Bowes have a legitimate concern in the litigation.

[683] In analyzing whether the assignment of a personal tort could be valid, the Alberta Court of Appeal referred to the policy reasons underlying champerty and maintenance at paragraphs 7 and 8 of *Margetts (Next Friend of) v Timmer Estate*, 1999 ABCA 268, 178 DLR (4th) 577:

> ...There are good reasons of public policy for not allowing an assignment because of the danger that the assignee may buy up the claim at a small figure and use it to get a big profit for himself. In short, all the evils which our forefathers saw in champerty [quoting Lord Dennning] ... the underlying concerns which motivate the rule are matters of public policy that attempt to safeguard the integrity of the trial process by minimizing the prospect of champerty and maintenance and abuse

> of process ... While inter-meddling for some collateral or oblique motive will not be tolerated, an assignment properly and fairly seen as having been entered into for the purpose of advancing the cause of justice will not be struck down.

[684] The Court quoted McLachlan, J.A. in *Fredrickson v Insurance Corp of British Columbia*, (1986), 3 BCLR (2d) 145 (CA) at 156:

> An assignment of a cause of action for non-personal tort is generally valid if the assignee has a sufficient pre-existing interest in the litigation to negate any taint of champerty or maintenance. In determining if this test is met, the court should look at the totality of the transaction ... A property interest ancillary to the cause of action assigned is sufficient to support an assignment, but not essential. A genuine pre-existing commercial interest will suffice. The term 'commercial interest' is used in the sense of financial interest; it need not arise from commercial dealings in the narrow sense.

[685] Although this case does not involve an assignment, the principles described by McLachlan, J.A. are useful in the analysis.

[686] It is clear that the top-lessees have promoted, directed and managed this litigation, and that they have funded it. They have presented a "no-lose" situation to the freeholder Plaintiffs, including no risk of an adverse costs award, in return for 50% of any damages awarded in the litigation.

[687] It is also clear that at the time the top-lessees promoted this arrangement, there were no problems between the freeholder Plaintiffs and the Defendants, other than the overpayment issue with the Oneil Group. It is likely, then, that the other freeholder Plaintiffs would not have brought the litigation without the risk-free opportunity afforded by the top-lessees, and the allegations of negligence and discriminatory production.

[688] On the other hand, the Oneil Group sought the assistance of the top-lessees when Mr. Oneil was concerned over the course of negotiations about the overpayment of royalties, and it is also clear that the freeholder Plaintiffs would likely have lacked the financial wherewithal to undertake expensive litigation on their own.

[689] The top-lessees submit that top-leases are accepted business practice in the oil and gas industry and that they do not interfere with the underlying lease. That is true, but it is not the top-leases that are the issue, but the conduct of 108 and Mr. Bowes in promoting and funding the litigation.

[690] While this conduct raises genuine concerns, I am satisfied that the top-lessees have a commercial interest arising from the top-leases sufficient to save them from a charge of maintenance. Concerns about any impropriety in their role in the litigation can be addressed through the mechanism of costs.

B. Interference with Contractual Relations

[691] The three-part test for intentional interference with contractual relations requires that:

a) the defendant intended to injure the plaintiff;
b) the means to accomplish this were unlawful; and
c) the plaintiff suffered economic loss as a result: *Polar Ice Express Inc v Arctic Glacier Inc*, 2007 ABQB 717; aff'd 2009 ABCA 20.

[692] The Defendants cannot establish the second part of this test, and thus this counter-claim must fail.

C. Set-Off

[693] Given my decision on the validity of the leases, it is not necessary to address set-off.

VIII. CONCLUSION

[694] The Plaintiffs advanced a claim for damages and declarative relief, alleging that five freehold petroleum and natural gas leases had terminated in accordance with their terms. The Plaintiffs also alleged unjust enrichment, trespass and conversion. For the reasons set out in these Reasons for Judgment, the Plaintiffs' claim is dismissed.

[695] In summary, I find that the leases did not terminate in accordance with their terms, and the claims for unjust enrichment, trespass and conversion are barred pursuant to the *Limitations Act*. Further, I find that some of the Plaintiffs do not have standing for some of their claims. Specifically, the Jerome Group Plaintiffs are not the proper parties to seek a declaration on the Scurry Leases, as Snell Farms and Wheatland may have an interest in the Scurry Leases and were not before the Court. Further, while 108 has standing before the Court on the issue of lease validity, it has no claim for damages.

[696] If I am in error in dismissing the action, I would award damages in restitution based on a royalty, or royalty plus bonus, approach, and not based on disgorgement of profits.

[697] The Defendants counter-claims in champerty and maintenance and interference with contractual relations are dismissed. If the parties are unable to agree on costs, they may make written submissions within 90 days of the date of these Reasons for Judgment.

Dated at the City of Calgary, Alberta this 22nd day of November, 2013.

B.E. Romaine
J.C.Q.B.A.

Appearances:

Peter T. Linder, Q.C. and S.B. Gavin Matthews
for the Plaintiffs/Defendants by Counterclaim

Richard F. Steele and Kevin Tuohy
for the Defendants/Plaintiffs by Counterclaim, Nexen Inc. and ExxonMobil Canada Ltd.

R. Craig Steele
for the Defendant/Plaintiff by Counterclaim, Bonavista Energy Corporation

David Percy Q.C.
for the Defendants/Plaintiffs by Counterclaim, Bonavista Energy Corporation, Coastal Resources Limited, Nexen Inc. and ExxonMobil Canada Ltd.

Catherine Crang
for the Defendant/Plaintiff by Counterclaim, Coastal Resources Limited

Chris Simard and Alexis Teasdale
for the Defendant/Plaintiff by Counterclaim, Esprit Exploration Ltd.

Michael D. Aasen
for the Defendant/Plaintiff by Counterclaim, TAQA North Ltd.

APPENDIX A - Summary of Leases

Section 25 Lands	Current Registered Minerals Owners	Original Leases	Current Lessee(s) Under Original Leases
Minerals Title #051 489 889 SW/4 of the Section 25 Lands (153.98 acres more or less)	Bowen Family Properties Ltd., Ronald B. Pole, Kevin R. Pole and Danny G. Oneil in his capacity as Executor of the Estate of Mabel B. Oneil (Deceased) (The **Bowen Group**)	Natural Gas Lease and Grant dated January 8, 1968 between Nellie B. Pole, as Lessor, and Jefferson Lake Petrochemicals of Canada Ltd., as Lessee (The **Jefferson SW/4 Lease**)	Nexen: 50% working interest ExxonMobil: 50% working interest
Minerals Title #101 187 324 NE/4 of the Section 25 Lands portion covering north 716 feet (43.39 acres more or less)	Edna Keam, Wilma Marshall and Laurel Lee McLaren (executrix for Betty Blanche Cardiff) (The **Irwin Group**)	Petroleum and Natural Gas Lease and Grant dated May 9, 1961 between Jean Ella Irwin, as Executrix of the Will of William James Irwin, Deceased, as Lessor and Union Oil Company of California, as Lessee (The **Union NE/4 Lease**)	Coastal: 100% working interest
Minerals Title # 741 049 399A NE/4 of the Section 25 Lands (remaining portion) (116.61 acres more or less)	½ interest registered to Jerome Development (The **Jerome Group**)	Petroleum and Natural Gas Lease and Grant dated November 30, 1967 between Merville V. Stewart as Lessor and Scurry-Rainbow Oil Limited as Lessee (The **Scurry NE/4 Lease**)	*Natural gas in BQ, Wabamun A and Elkton C formations Bonavista: 50% working interest Coastal: 50% working interest ______________ *All Petroleum and Natural Gas excluding Natural Gas in BQ, Wabamun A and Elkton C formations TAQA North 50% interest Coastal: 50% interest
Section 25 Lands	**Current Registered Minerals Owners**	**Original Leases**	**Current Lessee(s) Under Original Leases**

Minerals Title # 081 111 629 NE/4 of the section 25 Lands (remaining portion) (116.61 acres more or less)	½ interest registered collectively to James D. Stewart, Lynda Calder, Cody Stewart and Morgan Stewart (The **Jerome Group**, later transferred to **Jerome Development**)	Petroleum and Natural Gas Lease and Grant dated November 30, 1967 between Merville V. Stewart as Lessor and Scurry-Rainbow Oil Limited as Lessee (The **Scurry NE/4 Lease**)	Natural gas in BQ, Wabamun A and Elkton C formations Bonavista: 50% working interest Coastal: 50% working interest *All Petroleum and Natural Gas excluding Natural Gas in BQ, Wabamun A and Elkton C formations TAQA North 50% interest Coastal: 50% interest
Minerals Title # 741 049 399C SE/4 of the Section 25 Lands (160 acres more or less)	Jerome Development (The **Jerome Group**)	Natural Gas Lease and Grant dated January 7, 1964 between Merville V. Stewart as Lessor and Scurry-Rainbow Oil Limited as Lessee (The **Scurry SE/4 Lease**)	*Natural gas in BQ, Wabamun A and Elkton C formations Bonavista: 100% working interest *All natural gas excluding natural gas in BQ, Wabamun A and Elkton C formations TAQA North 100% interest
Minerals Title # 031 041 856 NW/4 of the Section 25 Lands (153.98 acres more or less)	Robert Copley, Karen Nell Copley, Margaret Alice Demers, Mary Jane Biggar, Goldie Alberta Danielsen (The **Copley Group**)	Lease and Grant dated December 13, 1961 between William Murdoch Copley, as Lessor and Imperial Oil Limited as Lessee (The **Imperial NW/4 Lease**)	Bonavista: 100% working interest

APPENDIX B - Diagram of Section 25 Lands

Section 25; Township 27; Range 1; W5M

<table>
<tr>
<td rowspan="2">NORTHWEST (153.98 acres)

The Imperial NW/4 Lease</td>
<td>NORTHEAST (north 716 feet) (43.39 acres)

The Union NE/4 Lease</td>
</tr>
<tr>
<td>NORTHEAST (south of the north 716 feet) (116.61 acres)

The Scurry NE/4 Lease</td>
</tr>
<tr>
<td>SOUTHWEST (153.98 acres)

The Jefferson SW/4 Lease</td>
<td>SOUTHEAST (location of 7-25 Well) (160 acres)

The Scurry SE/4 Lease

☆ ← 7-25 Well</td>
</tr>
</table>

APPENDIX C - Lease Provisions

The Jefferson SW/4 Lease and the Union NE/4 Lease contain the following relevant clauses, broken down into sub-clauses. Certain portions have been italicized for emphasis and editorial designations are provided in square brackets for ease of analysis.

Jefferson SW/4 Lease

[698] The habendum clause of the Jefferson SW/4 Lease is as follows:

> TO HAVE AND ENJOY the same for the term of Ten (10) years from the date hereof and so long thereafter as the leased substances or any of them are produced from the said lands or the pooled lands subject to the sooner termination of the said term as hereinafter provided:
>
>> [Firstly] PROVIDED that if operations for the drilling of a well are not commenced on the said lands or the pooled lands within one year from the date hereof, this Lease shall terminate and be at an end on the first anniversary date, unless the Lessee shall have paid or tendered to the Lessor ... the sum of One Hundred and Fifty-three 98/100 ($153.98) Dollars, (hereinafter called the "delay rental"), which payment shall confer the privilege of deferring the commencement of drilling operations for a period of one year from said anniversary date, and that, in like manner and upon like payments or tenders, the commencement of drilling operations and the termination of this Lease shall be further deferred for like periods successively;
>>
>> [Secondly] PROVIDED FURTHER that if at any time during the said Ten year term and prior to the discovery of production on the said lands or the pooled lands, the Lessee shall drill a dry well or wells thereon, or if at any time during such term and after the discovery of production on the said lands or the pooled lands such production shall cease and the well or wells from which such production was taken shall be abandoned, then this Lease shall terminate at the next ensuing anniversary date hereof unless operations for the drilling of a further well on the said lands or the pooled lands shall have been commenced or unless the Lessee shall have paid or tendered the delay rental, in which latter event the immediately preceding proviso hereof governing the payment of the delay rental, and the effect thereof, shall be applicable thereto;
>>
>> [Thirdly] AND FURTHER ALWAYS PROVIDED that

[I] if at the end of the said Ten (10) year term the leased substances are not being produced from the said lands or the pooled lands and the Lessee is then engaged in drilling or working operations thereon, <u>or</u>

[II] if at any time after the expiration of the said Ten (10) year term production of the leased substances has ceased *and* the Lessee shall have commenced further drilling or working operations within Ninety (90) consecutive days after the cessation of said production,

then this Lease shall remain in force so long as

[Permutation 1] any drilling or working operations are prosecuted with no cessation of more than Ninety (90) consecutive days, and,

[Permutation 2] if they result in the production of the leased substances or any of them, so long thereafter as the leased substances or any of them are produced from the said lands or the pooled lands;

provided that,

[Amelioration A] if drilling or working operations are interrupted or suspended as the result of *any cause whatsoever beyond the Lessee's reasonable control*,
<u>or</u>

[Amelioration B] if *any* well on the said lands or the pooled lands or on any spacing unit of which the said lands or any portion thereof form a part, is shut in, capped, suspended or otherwise not produced *as the result of a lack of or an intermittent market, or any cause whatsoever beyond the Lessee's reasonable control,*

the time of such interruption or suspension or non-production shall not be counted against the Lessee, anything hereinbefore contained or implied to the contrary notwithstanding:

The following covenant contained in the body of the Lease are also relevant:

3. Shut-In Gas Wells

a) If all wells on the said lands or the pooled lands are capped, shut-in, suspended or otherwise not produced during any year ending on an anniversary date, *as the result of a lack of or an intermittent market or any cause whatsoever beyond the Lessee's reasonable control,*

the Lessee shall pay to the Lessor at the expiration of each such year a sum equal to the delay rental hereinbefore set forth and each such well shall be deemed to be a producing well hereunder.

Union NE/4 Lease

[699] The Union NE/4 Lease contains substantially similar habendum and proviso provisions, except that the amelioration clauses of the Third Proviso are slightly different as follows:

> PROVIDED THAT [Amelioration A] if drilling, working or production operations are interrupted or suspended *as the result of any cause whatsoever beyond the Lessee's reasonable control including, in the case of production operations, lack of or an intermittent market,* the time of such interruption or suspension shall not be counted against the Lessee, anything hereinbefore contained or implied to the contrary notwithstanding.

[700] The Shut-in Well provision is also slightly different, as follows:

> 2. Shut-in Wells
> If all wells on the said land or on land with which the said lands are pooled or combined are shut-in, suspended or otherwise not produced during any year ended on an anniversary of the date hereof *as the result of a lack of or an intermittent market, or any cause whatsoever, beyond the Lessee's reasonable control,* the Lessee shall pay to the Lessor at the expiration of each said year a sum equal to the annual rental hereinbefore set forth, and each such well shall be deemed to be a producing well hereunder.