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Cowper-Smith and the Law of Proprietary Estoppel: Implications for the Oil and Gas Lease?

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Case Commented On: *Cowper-Smith v Morgan*, 2017 SCC 61 (CanLII)

The Supreme Court of Canada handed down its decision in *Cowper-Smith v Morgan* in December 2017. The decision is an important decision on proprietary estoppel. While it arises in the context of a family dispute it deserves to be read by commercial lawyers including oil and gas lawyers. It is one of the curiosities of the Canadian law of estoppel that some of our leading cases have come out of fact patterns involving the "unless" form of the oil and gas lease from the 1960s and 1970s from Alberta and Saskatchewan. These cases include *Canadian Superior Oil Ltd. v Paddon-Hughes Development Co.*, [1970] S.C.R. 932, 1970 CanLII 3 (SCC) and *Sohio Petroleum Co. v Weyburn Security Co.*, [1971] S.C.R. 81, 1970 CanLII 137 (SCC). These cases continue to be influential in oil and gas lease matters and beyond. The typical fact pattern involves a missed or late payment during the primary term or a missed or late shut-in payment during the secondary term which automatically terminates the lease unbeknownst to either party. The parties continue to act as if the lease is in force and in some cases the lessee expends considerable monies on the leased lands including drilling a new well. But in the end, all is for naught. The lease is dead and to this point estoppel arguments aimed at reviving the lease have largely failed; in some cases on the basis that estoppel cannot be used as a sword (to create a new lease), and in other cases, and most commonly, on the basis that the lessee never acted to its detriment on the basis of a representation made by the lessor that the lease was still in effect; typically there was no such representation, the lessee was simply proceeding on the basis of its own understanding of the legal position.

Many of these cases canvass all sorts of different forms of estoppel including estoppel by representation, estoppel by deed, promissory (High Trees) estoppel and, in particular, estoppel by acquiescence. Estoppel by acquiescence (as the name suggests) is characterized by an implied rather than an express representation and as a result the courts have jealously guarded access to this form of estoppel through an arcane set of rules known as the five probanda of Willmott v Barber (1880), 15 Ch. D. 96, at 105-6.

> It has been said that the acquiescence which will deprive a man of his legal rights must amount to fraud, and in my view that is an abbreviated statement of a very true proposition. A man is not to be deprived of his legal rights unless he has acted in such a way as would make it fraudulent for him to set up those rights. What, then, are the elements or requisites necessary to constitute fraud of that description? In the *first* place the plaintiff must have made a mistake as to his legal rights. *Secondly*, the plaintiff must have expended some money or must have done some act (not necessarily upon the

> defendant's land) on the faith of his mistaken belief. *Thirdly*, the defendant, the possessor of the legal right, must know of the existence of his own right which is inconsistent with the right claimed by the plaintiff. If he does not know of it he is in the same position as the plaintiff, and the doctrine of acquiescence is founded upon conduct with a knowledge of your legal rights. *Fourthly*, the defendant, the possessor of the legal right, must know of the plaintiff's mistaken belief of his rights. If he does not, there is nothing which calls upon him to assert his own rights. *Lastly*, the defendant, the possessor of the legal right, must have encouraged the plaintiff in his expenditure of money or in the other acts which he has done, either directly or by abstaining from asserting his legal right. Where all these elements exist, there is fraud of such a nature as will entitle the Court to restrain the possessor of the legal right from exercising it, but, in my judgment, nothing short of this will do. (emphasis added)

There is perhaps only one oil and gas lease case in which this plea of estoppel by representation has successfully been made out and that was because all the elements of the estoppel were established before the primary term of the lease had expired. In other words, estoppel was used to continue the lease rather than to revive a dead lease. The case is *Voyager Petroleums Ltd. v Vanguard Petroleums Ltd*., 1983 ABCA 197 (CanLII), and the case entailed a painstaking application of the five probanda.

There is however one form of estoppel that can be used as a sword and that is proprietary estoppel; and it is that form of estoppel that was at issue in *Cowper-Smith v Morgan*. This post summarizes *Cowper-Smith v Morgan* and then considers its possible application in the oil and gas lease context.

The Facts

Elizabeth and Arthur raised three children in Victoria BC: Gloria, Max and Nathan. Gloria stayed in Victoria; Max went to England and practised law; Nathan moved to Edmonton. Arthur died in 1992. Elizabeth executed her last will in 2002 appointing Gloria as her executor and providing that her estate should be equally divided between the three children. However, a year or so earlier, Elizabeth had transferred title to the family home and all of her investments into joint ownership with Gloria. There was also a declaration of trust indicating (at para 8) that "Gloria would hold her interests in the house and the investments as bare trustee, with Elizabeth as the sole beneficiary, and Gloria would be 'entitled . . . absolutely' to both the property and the investments upon her mother's death." Elizabeth's final will did not change that declaration of trust.

By 2005 it was clear that Elizabeth could no longer live on her own. Gloria and Max discussed options. Eventually it was agreed between them (at para 7) that Max would "give up his life in England, to move back to Victoria, and to care for their mother and the family home [but] only after Gloria agreed that Max would be reimbursed for various expenses, have the use of their mother's car, and, crucially, be able to live in the house permanently and eventually to acquire Gloria's one-third interest in the same." Max made the move and took care of Elizabeth and the family home. Along the way (and when the two brothers found out that Gloria's name was on title) Gloria assured each of them (at para 9) "that the arrangement was to simplify the

administration of their mother's estate and that [both] would still each receive a one-third share" of the estate.

Eight months after Elizabeth had died Gloria took the position that she was absolutely entitled under the declaration of trust (i.e. it amounted to a gift which rebutted the presumption of a resulting trust: *Pecore v Pecore*, 2007 SCC 17 (CanLII)) and announced plans to put the family home on the market. Nathan and Max commenced this action seeking an order setting aside the 2001 trust declaration as the product of Gloria's undue influence over Elizabeth and declaring that Gloria therefore held the property and investments in trust for Elizabeth's estate on a resulting trust, to be divided equally between the three children in accordance with the 2002 will. Max also claimed, on the basis of proprietary estoppel, that he was entitled to purchase Gloria's one-third interest in the house. The trial judge found in favour of the brothers on all grounds. The Court of Appeal agreed that Gloria held the property on a resulting trust for the estate but the majority concluded that Max had failed to establish the elements of a proprietary estoppel since, at the relevant time, Gloria (by virtue of the prior holding), did not own an interest in the property.

The only issue before the Supreme Court of Canada was the issue of proprietary estoppel and, if established, the appropriate remedy.

Chief Justice McLachlin

In giving the leading judgment Chief Justice McLachlin concluded that (at para 23) in order "to establish proprietary estoppel one must first establish an equity of the kind that proprietary estoppel protects." Such an equity arises (at para 15) "when (1) a representation or assurance is made to the claimant, on the basis of which the claimant expects that he will enjoy some right or benefit over property; (2) the claimant relies on that expectation by doing or refraining from doing something, and his reliance is reasonable in all the circumstances; and (3) the claimant suffers a detriment as a result of his reasonable reliance, such that it would be unfair or unjust for the party responsible for the representation or assurance to go back on her word …". Then (at para 15), if "the party responsible for the representation or assurance possesses an interest in the property sufficient to fulfill the claimant's expectation, proprietary estoppel may give effect to the equity by making the representation or assurance binding."

In this case there was clearly (at para 24) a representation or assurance and reliance to detriment; the only issue was whether Max's reliance on that assurance was reasonable. The majority of the Court of Appeal had effectively ruled that Max's reliance could never be reasonable if the promisor did not have a present interest in the property at the time of the representation. The Chief Justice however considered that such a bright line rule was (at para 29) "out of step with equity's purpose, which is to temper the harsh effects of strict legal rules." While the Chief Justice was prepared to assume that in some fact patterns it may be the case (at para 29) "that the party responsible for the expectation had such a speculative interest in the property that the claimant's reliance could not have been reasonable" in this case the trial judge had assessed that the reliance was reasonable. That assessment was a mixed question of fact and law and as such entitled to deference absent palpable and overriding error. The Chief Justice saw no reason to interfere (at paras 31-33):

> [O]n the trial judge's findings, both Max and Gloria had clearly understood for well over a decade that their mother's estate, including the house in which she lived, would be divided equally among her three children upon her death. Nathan, Max, and Max's ex-wife each testified to a conversation with Elizabeth and Arthur, just prior to Arthur's death in 1992, in which both parents made clear that everything they owned would be divided equally among their three children once Elizabeth passed away. Max's evidence was that Elizabeth confirmed as much to him in 2002. Gloria conceded at trial that, in the years before her mother's death, she made statements evincing the same expectation. She departed from that position — and asserted that she was entitled to *all* of her mother's assets, the house included — only in April 2011.
>
> It was thus sufficiently certain that Gloria would inherit a one-third interest in the property for her assurance to be taken seriously as one on which Max could rely. Max and Gloria negotiated for an extended period before Max uprooted his life in England and returned to Victoria. Gloria promised unequivocally that he would be able to acquire her share of the property if he did so. She made that commitment, among others, with the purpose of enticing him back to the family home. In this, she succeeded. I see no basis on which to overturn the trial judge's conclusion that, in these circumstances, Max's reliance was reasonable.
>
> Max reasonably relied on the expectation that he would be able to acquire Gloria's interest in the property once their mother's estate had been administrated in the usual course.

Not only was the reliance reasonable there was also no rule of law or equity that required the promisor to have an interest in the relevant land at the time of the promise or at the time of the reliance. Instead (at para 35):

> An equity arises when the claimant reasonably relies to his detriment on the expectation that he will enjoy a right or benefit over property, whether or not the party responsible for that expectation owns an interest in the property at the time of the claimant's reliance. Proprietary estoppel may not protect that equity immediately. It may not protect the equity until considerable time has passed. If the party responsible for the expectation never acquires a sufficient interest in the property, proprietary estoppel may not arise at all; where there is proprietary estoppel, there must be an equity, but not vice versa. When the party responsible for the expectation has or acquires a sufficient interest in the property, however, proprietary estoppel attaches to that interest and protects the equity …

In this case Gloria did not have an interest in the property at the time of reliance to detriment; the property was still part of Elizabeth's residuary estate. But this was an appropriate case in which to require the executor (Gloria) to make an *in specie* distribution of the home, at which point the estoppel would attach and Gloria would be required to sell her interest in the property to Max as originally promised. But at what price?

Chief Justice McLachlin concluded that Gloria's interest should be valued on the basis of its value at the time when Elizabeth's estate would have been administered in the ordinary course; not on the basis of when the estoppel crystallized.

Justice Brown

Justice Brown dissented on the issue of the remedy. In his view, the equity in favour of the promisee does not arise at the moment of detrimental reliance but only (at para 65) "if and when the promisor obtains the right or benefit that was promised to the claimant." There might be an "inchoate equity" at the point of reliance but "such an equity cannot confer a *proprietary* right in the promised property, but rather a mere *personal* right against the promisor" (the emphasis is Justice Brown's). The Chief Justice had concluded that it was not necessary to decide if the proprietary estoppel remedy was proprietary or personal in nature (at para 15) but Justice Brown did not think that the issue could be avoided. In his view (at para 67) this form of estoppel must be proprietary "because it must be capable of compelling a promisor to relinquish a proprietary right which he or she actually holds." Since it could only be unconscionable for Gloria to refuse to honour her promise once she had gained an interest in the land, it followed that all that could be required in this case (at para 71) was "to permit Max to purchase Gloria's one-third share of the property as of the date of this Court's order."

Justice Côté

Justice Côté's separate concurring reasons (dissent?) went further. For her it was important that the remedy not do violence to the intentions of the testatrix. In this case Elizabeth had directed (at para 75) that Gloria "may convert [the] estate . . . into money, and decide how, when, and on what terms", or that she "may keep [the] estate, or any part of it, in the form it is in at [Elizabeth's] death". The effect of the *in specie* remedy directed by the Chief Justice was (at para 76) "to substitute the Court's own judgment for that of Gloria in determining how the property should be administered." Furthermore, the effect of permitting Max to buy at a price based on value at the time of expected administration of the estate violated Elizabeth's expressed intention of benefiting all her children equally. Justice Côté noted several reasons why Gloria (or any executor) might not favour an *in specie* distribution; and *if* Gloria was conflicted (remarkably Justice Côté does not seem to be fully convinced that Gloria's self-interest might conflict with her duty of loyalty) then (at para 80) the correct remedy was to replace Gloria as executor. In sum, Justice Côté would have rendered the proprietary estoppel remedy completely contingent on the decision of a third party to make an i*n specie* distribution (or not). Finally, and in the alternative (at para 82), Justice Côté agreed with Justice Brown that the price of Gloria's share of the property should be determined as of the date of the Court's order since again this would be most consistent (at para 82) with the testatrix's wishes:

> … the testatrix wanted each child to share equally in the residue of her estate. In a rising market, letting Max buy the one third interest for a past price does not respect her wishes since it effectively gives Gloria less than one third of the current value of the estate, and correspondingly more to Max.

What are the Broader Implications of this Decision?

In some respects this was an easy case insofar as there was a clear representation or assurance and a very clear reliance to detriment. The only substantial difficulty related to the fact that the representor had no present interest in the land. That created two challenges. First, it was said to be grounds for questioning whether the representee's actions were reasonable, and, second, it was potentially a complete bar to the availability of the remedy, especially in this case because the promisor was armed with the means to ensure that she never took an estate in possession. Notwithstanding Justice Côté's reservations, both of these difficulties (but especially the second) were technical in nature and no court of conscience was going to allow Gloria to use the standard powers conferred by the will on an executor to frustrate the operation of the estoppel. Thus, one lesson from the decision is that in considering estoppel arguments the Court will look for substance over form and will examine the overall context rather than (at para 29) "*ex ante* doctrinal restrictions". There is other evidence of this approach in the Chief Justice's judgment. Thus, in an early passage articulating the three main elements of an estoppel (at para 18), Chief Justice McLachlin notes that "recent decades have seen a softening" in the application of the five probanda from Willmott v Barber (1880), 15 Ch. D. 96, at 105-6 and a movement away "from strict requirements that would constrain their ability to do justice in the circumstances of a particular case …". But at the same time (at para 19) "flexibility must not come at the expense of clarity and predictability". What I infer from this is that we should not expect courts to apply the five probanda in a rote manner; but neither should we expect or allow courts to pose a question as general as "would it be unconscionable to allow the promisor to resile from her promise or representation"—such a question cannot serve as a stand-alone criterion but it might serve as the test of an outcome (at para 20) —"what proprietary estoppel aims to avoid by keeping the owner to her word."

Resolving the tension between flexibility on the one hand, and clarity and predictability on the other, might well require a court to develop more contextualized criteria for different types of situations. For example, and in the context of an oil and gas lease, the issue of representation or assurance might be framed in terms of "what did the lessor do (words, actions etc) to make the lessee believe that it had a valid lease?" Similarly, with respect to both reliance and action to detriment the issue might be framed in terms of what did the lessee do on the basis of the assurance? Thus, the onus will still be on the lessee to establish some causal connection between the assurance and the reliance translated into action to detriment. If the lessee did what it did solely because of its own understanding of its position then it is hard to see why even a flexible rule should offer any relief. The final question might then be: "in all the circumstances, would it be unconscionable for the lessor to deny that the lease was still in effect?"

The focus on proprietary estoppel rather than other forms of estoppel might also result in some "softening" in the context of the oil and gas lease especially if one considers the remedies elements of the Chief Justice's opinion. Again this will serve to allow the court to focus on the substance of the requirements rather than formal requirements such as the "click" date of the lease. By analogy here, the Court was less concerned with whether Gloria had an interest in the property when she made the promise and when Max relied upon it, and was more concerned with attaching the equity to the property whenever (and howsoever) Gloria acquired an interest. Similarly, the key ideas that seem to inform the remedy include such principles as (see at para

47): (1) the claimant is entitled only to the minimum relief necessary to satisfy the equity, and (2) there must be a proportionality between the remedy and the detriment. In the oil and gas lease context the following observations seem pertinent. First, unlike the fact pattern in *Cowper-Smith* we are not likely to run into a situation where the promisor lacks the necessary proprietary estate to make amends—in the oil and gas lease scenario, the lessor will typically have the fee simple title to the mineral estate. Second, the remedy the lessee will most likely seek will be limited in nature; it will not require a divestment of the mineral estate of the lessor; instead the lessee will seek the extension of the primary term of a lease or the grant of a new lease on similar terms. While both involve more than the use of estoppel as a shield neither seems obviously and categorically disproportionate (although we will of course need to know more about the particular circumstances). Furthermore, there is at least some evidence of the courts experimenting with this idea through the doctrine of leave and licence: see *Montreal Trust Co. v. Herc Oil Corp*., 2004 SKCA 116 (CanLII).

But the bottom line turns on whether we can point to an oil and gas lease case that might be decided differently as a result of *Cowper-Smith*. It will still be a tough argument in many cases because of the difficulty of demonstrating the lessee's reliance on the lessor's representation. So let me close this post by reviewing some of the elements of the well-known facts of *Sohio Petroleum Co. v Weyburn Security Co.* as summarized by Justice Martland:

> The words and conduct of the respondent relied upon by the appellants as creating an estoppel were that:
>
> (1) The respondent had called upon Sohio to drill an offset well, in accordance with the requirements of the lease, which well was drilled.
>
> (2) Sohio, at the request of the respondent, had paid seven-eighths of the mineral taxes imposed on the leased lands, which was a requirement of the lease.
>
> (3) Sohio had paid and the respondent had accepted, royalties based upon the production from the leased lands.
>
> (4) The respondent had permitted Sohio to enter a pooling unit, involving the leased lands, which, under the lease terms, Sohio would have had the right to do without the respondent's consent.

The one fact that always sticks in the craw is fact # 1: the lessor, relying on the terms of the lease, demanded that the lessee drill an offset well. If we apply the re-framed tests developed above rather than the five probanda of *Wilmott v Barber*, then I think that we might have a case that would go the other way. But clearly this was an extraordinary set of facts not readily replicated.

Consider the following (each consists of a proposition from para 15 of the Chief Justice's judgment in *Cowper-Smith* followed by a statement of fact from *Sohio v Weyburn*, followed by my comments in italics).

(1) A representation or assurance is made to the claimant, on the basis of which the claimant expects that he will enjoy some right or benefit over property.

> The respondent had called upon Sohio to drill an offset well, in accordance with the requirements of the lease, which well was drilled.
>
> *It is true that there is no express assurance of a valid lease but the underlying premise is surely that there is a valid lease. Note that in the* post-Willmott v Barber *era there is no discussion of the respective knowledge by the two parties of their legal rights.*

(2) The claimant relies on that expectation by doing or refraining from doing something, and his reliance is reasonable in all the circumstances.

> The respondent drilled the well.
>
> *It would be reasonable to drill the well if the lease were in force; it would be completely unreasonable to drill on a dead lease. The lessee's response to the lessor's demand provides the necessary causal nexus.*

(3) The claimant suffers a detriment as a result of his reasonable reliance, such that it would be unfair or unjust for the party responsible for the representation or assurance to go back on her word.

> *The detriment is self-evident; the cost of drilling the well. It is unconscionable for the lessor to deny the common premise of a valid lease which was the basis on which the lessor demanded that the lessee drill the well.*

(4) And if the party responsible for the representation or assurance possesses an interest in the property sufficient to fulfill the claimant's expectation, proprietary estoppel may give effect to the equity by making the representation or assurance binding.

> *The lessor has the necessary estate in land to extend the lease or re-grant a new lease; this would fulfil the lessee's expectation. The fact that this requires that the estoppel operates as a sword should not be problematic. Is there a lesser remedy that satisfies the lessee's expectations? No. It is true that the Supreme Court did not require Sohio to disgorge its production from the dead lease; but the premise of the proprietary estoppel remedy is fulfilment of expectations, not that of ensuring that the representor is not unjustly enriched.*

Thanks to Pat McGuire for comments on a draft of this post and for pushing me to elaborate upon these final conclusions: any remaining errors are of course my responsibility.

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