

May 15, 2019

Summary Judgment Not Available in a Farmout Case

By: Nigel Bankes

Cases commented on: (1) *Teine Energy Limited v Audax Investments Ltd*, unreported oral judgment delivered from the bench October 2, 2018 ([Transcript of Proceedings](#)), (2) *Teine Energy Limited v Audax Investments Ltd*, unreported oral judgment delivered from the bench March 21, 2019 (ABQB), and (3) *Teine Energy Limited v Audax Investments Ltd*, [2019 ABQB 334](#) (ABQB Ruling on Costs)

Teine and Audax entered into a farmout agreement on November 24, 2016. The agreement took the form of a proposal from Teine (as the farmor) to Audax as the proposed farmee, which proposal Audax accepted. The agreement contemplated that in return for drilling the commitment well (or wells), Audax would earn a 100% interest in Taine's Saskatchewan Crown petroleum and natural gas lease, subject to a 17.5% gross overriding royalty in favour of Teine. The agreement incorporated by reference the 1997 Canadian Association of Petroleum Landmen *Farmout and Royalty Procedure*.

The case turns on clauses 3 and 4 of the farmout agreement:

3. Commitment Wells

a) Farmee commits that on or before January 31, 2017 (the "commitment Date"), subject to rig availability, surface access, weather, terrain, and regulatory approval, Farmee shall drill and Complete one (1) Horizontal Well or two (2) vertical wells (the "Commitment Well") to Contract Depth, at a location of its choice on the Farmout Lands.

4. Failure to Drill

a) If Farmee fails to spud the Commitment Well on or before the Commitment Date (the "Failure to Drill") then the parties acknowledge and agree that Farmor will suffer and incur damages that may include, without limitation, any or all of, the loss of potential royalties, production revenue, road use fees and third party transportation and processing revenue, the loss of lease rentals, title document tenure reduction, payments made to extend title documents, the loss of an opportunity to gain well and seismic information, loss of goodwill with business partners and regulators, increased administrative burden and, if applicable, the failure to satisfy offset or compensatory royalty obligations (the "Damages for Failure to Drill").

b) Farmee agrees to pay the sum of \$250,000.00 to Farmor as liquidated damages and not as a penalty for the Damages for Failure to Drill (the "Failure to Drill Payment"). The

Failure to Drill Payment will be paid within 30 days of Farmor's written demand for payment. It is further agreed that the Failure to Drill Payment is a genuine pre-estimate of Damages for Failure to Drill.

c) Upon receipt of the Failure to Drill Payment, Farmer shall have no right to claim from Farmee further damages or remedies from Farmee with respect to the Damages for Failure to Drill.

d) Nothing in this Clause shall be interpreted so as to restrict or extinguish Farmor's right to claim damages or remedies from Farmee with respect to damages other than Damages for Failure to Drill.

The provision (clause 3) that gave the farmee the option to drill two vertical wells or one horizontal well was inserted at the request of Audax.

Teine's Crown lease was subject to some potential restrictions on access as follows:

(a) Heritage Sensitive

These lands are considered heritage sensitive either in whole or in part. They contain recorded archaeological, historical, or palaeontological sites or are judged to have high site potential due to their proximity to major waterways, lakes, sheltered valleys, hummocky terrain, or other heritage sensitive landforms. Petroleum developments on these lands may require heritage resource impact assessment, pursuant to Section 63 of *The Heritage Property Act*, prior to any land disturbance.

(b) Heritage Protection Areas

These lands are protected by provincial heritage designated pursuant to Part IV of *The Heritage Property Act* or are under consideration for such protection. They may also contain Sites of a Special Nature as defined in Section 64 of the Act. As such, surface alteration of any kind or permanent visual impact on the land parcels so indicated will be restricted or prohibited. Drilling from neighbouring lands may have similar restrictions and/or may require appropriate reclamation procedures to mitigate the visual impact of petroleum facility construction and removal.

(c) Environmentally Sensitive

These lands either in whole or in part contain an environmentally sensitive area and as such will require an Oil and Gas Project Proposal (OGP) be submitted to Lands Branch for environmental review before the proposed activity may proceed. Activities that may meet the definition of a 'development' under *The Environmental Assessment Act* will be forwarded to the Environmental Assessment Branch and may require an Environmental Impact Assessment and Ministerial Approval prior to proceeding.

(d) Wildlife Habitat

These lands either in whole or in part are subject to the *Wildlife Habitat Lands Disposition and Alteration Regulations* under *The Wildlife Habitat Protection Act*. Lands designated under *The Wildlife Habitat Protection Act* are protected for natural and wildlife values. A detailed review is necessary prior to any development on these lands. Surface alteration to these lands may not be granted without prior approval of the Ministry of Environment.

Without going into all of the details, the Government of Saskatchewan asked Audax to prepare additional studies including a prairie grass study and a heritage resource impact assessment. Overall, Audax encountered significant difficulties in acquiring the necessary approvals to drill its first proposed well and one proposed location was rejected. Teine granted an extension of the commitment well date from January 31, 2017 to November 30, 2017. On January 12, 2018 Teine sent Audax a written demand for payment of \$250,000 based on the language of clause 4 of the agreement and subsequently commenced this action by way of a statement of claim filed on March 14, 2018.

Audax filed a defence. Both parties filed affidavits and cross examined on those affidavits. Teine sought summary judgment on the basis of that record. Master Farrington rejected that application, as did Justice Neufeld on appeal.

The transcript of proceedings of the application before Master Farrington reveals that Teine's application was based upon what Teine's counsel termed the binary nature of the obligation under the farmout agreement: i.e. drill the commitment well(s) within the period prescribed or make the payment described in clause 4. Teine characterized clause 4 as a liquidated damages clause based upon a genuine pre-estimate of damages and not a penalty. In emphasizing the binary nature of Audax's obligation, counsel for Teine downplayed the significance of the "subject to" language in clause 3 of the agreement.

Master Farrington found it unnecessary to hear from counsel for Audax and dismissed the application for summary judgment. He reasoned as follows (Transcript of Proceedings, October 2, 2018)

... the interpretation that I would favour is an interpretation that incorporates and makes use of the words subject to rig availability, surface access, weather, terrain and regulatory approval. Paragraph 4(a) and 4(b) specific (*sic*) of the agreement particularly refer to the Commitment Well which is a defined term in paragraph 3(a). The Commitment Well definition, in my view, is not altered by the comma in the sense (*sic*, perhaps 'sentence'?). In my view, the Commitment Well, probably the interpretation is it does include those conditions in it. And, in my view, that is sufficient for the purpose of finding that the case for summary judgment has not been made out.

I don't want to say anything more about sort of the issues generally, given that I've found that summary judgment is not available today. There's other issues here such as the good faith issues, such as whether there was sufficient compliance with trying to pursue the

various things along the way in terms of the conditions. There's counterclaims here, there's various other things. So, in my view, a trial is necessary, at least based on the record before the Court at this stage. And, notwithstanding Mr. Stead's best efforts, I just don't think the case for summary judgment and summary determination of the issues has been made out so I dismiss the application for summary judgment. (at 22-23)

Teine appealed. Justice Neufeld's ruling on costs indicates simply that (at para 3) "An appeal was taken from the Master's decision. I dismissed the appeal with reasons from the bench on March 1, 2019." A transcript of those reasons is not available so far as I know. On the costs issue itself Justice Neufeld went on to observe:

While the *Rules of Court* allow for summary disposition before a Master, and *de novo* appeals from such a decision, it does not follow that meritless appeals should be encouraged. The contractual interpretation advanced before the Master and me on appeal was one that plainly could not succeed. Teine was entitled to advance its interpretation and did so ably through counsel, but it must accept the cost consequences of doing so.

I am therefore ordering Teine to pay \$12,000.00 in costs, inclusive of disbursements. (at paras 7-8)

This post draws on four documents in addition to Justice Neufeld's ruling on costs: (1) the farmout proposal (agreement), (2) the statement of claim, (3) the [transcript of the proceedings](#) before Master Farrington, and (4) the Affidavit of Dallas Duce (Duce is the President and Director of Audax).

While only a ruling declining summary judgment, the ruling does contribute to the growing body of case law since the Supreme Court of Canada's decision in *Hryniak v Mauldin*, [2014 SCC 7](#) in which the courts have granted (or more frequently declined to grant), summary judgment in oil and gas contract cases.

For oil and gas cases where the courts have declined summary judgment see: *P. Burns Resources Limited v Locke, Stock and Barrel Company Ltd.*, [2014 ABCA 40](#), and for the ABlawg post see [here](#); *Talisman Energy Inc v Questerre Energy Corporation*, [2017 ABCA 218](#), and for the ABlawg post see [here](#); *Precision Drilling Canada Limited Partnership v Yangarra Resources Ltd*, [2017 ABCA 378](#), and for the ABlawg post see [here](#); *Desoto Resources Limited v. Encana Corporation*, [2011 ABCA 100](#) and for the ABlawg post see [here](#);

For cases in which the courts have granted summary judgment see: *SemCAMS ULC v Blaze Energy Ltd*, [2016 ABCA 113](#), and for the ABlawg post see [here](#); and *Shallow Gas Drilling Corp v Legacy Oil and Gas*, [2015 ABQB 606](#), and for the ABlawg post see [here](#).

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