THE CONTINUING ADVENTURES OF THE OIL AND GAS LEASE

JOHN BISHOP BALLEM *

Calgary

There have been two recent developments at the Supreme Court of Canada level in the remarkable body of law that surrounds the oil and gas lease. First, we have an intriguing possibility that the court may be veering toward a more liberal interpretation of the lease and secondly, the annihilation of estoppel as a means of reviving a defunct lease.

I. *A New Approach?*

Observations such as "having regard to usual oil field practice"; "It is sufficient if . . . production is obtained . . . with reasonable diligence and dispatch"; "it is not reasonable . . . to apply so stringent an interpretation"; "a *bona fide* intention to proceed diligently"; "I do not construe this to mean that . . . the production must commence immediately upon the completion of drilling operations", fall strangely upon the ears of oil and gas lawyers attuned to a harsher judicial refrain. In the past two decades, lessees have quailed and leases have fallen before such stern judicial pronouncements as: "carries within its own phraseology an automatic termination which clicks"; "if, as I think to be the case, what the proposed lessee intended to provide for was . . . unfortunately the language employed is quite insufficient for such purpose". "However, irrespective of what construction may have been placed by courts upon other leases, the essential task in the present case is to construe the terms of the lease which is in question." "The wording of that clause does not extend beyond . . . ."

The Supreme Court has consistently and properly abjured against stretching the implications of any decision beyond the particular facts and documentation in each case. Nonetheless there has been a lengthy parade of cases which disclose a discernible pattern.[1] One could assume with confidence that: (a) the

* John Bishop Ballem, Q.C., of the Alberta Bar, Calgary.

[1] The line of cases is well known and much written about, see, generally, Ballem, The Perilous Life of an Oil and Gas Lease (1966), 44 Can. Bar Rev. 523; Dunnet, Floyd, Hetland, Johnson, Lebel, Mahaffey, Mac-

wording of the document would be construed strictly; (b) any ambiguity would be resolved against the lessee; (c) only the actual language of the document itself would be considered and (d) the court would not attach weight to the intention of the parties or to such imponderables as industry practice and usage. This approach led to the demolition of leases and the extinction of enormously valuable property rights under conditions which stunned and bewildered the corporate lessees and which on occasion troubled the court itself. "I come to the conclusion that this appeal should fail with regret as I am by no means satisfied that the result accords with the intention of the parties to the instrument."[2]

As a consequence of this approach leases were held to have terminated under the following conditions:[3] where a definition of "said lands" could not be expanded by the act of pooling to include the entire production unit for a gas well;[4] where a pooling clause provided that the lands could be pooled "when such pooling or combining is necessary in order to conform with any regulations or orders of the Government of the Province of Alberta or any other authoritative body" and it was held that this requirement was not met even though it was necessary to pool the leased lands with other lands to form a spacing unit in order to obtain the approval of the Conservation Board to produce the leased substances;[5] where a suspended well payment was made a week late;[6] where a well was being drilled near the end of the primary term and operations were suspended because of road bans (due to spring break-up) and the suspended operations were not renewed until the road ban was lifted, some twelve days after the expiration of the primary term;[7] where a well com-

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Innes, Wyman, Prolonging the Lease by Production and Drilling (1965-1966), 4 Alta L. Rev. 231; Curran, Effect of Amendments to Petroleum and Natural Gas Leases, *ibid.*, at p. 267; Currie, Recent Cases and Developments in Oil and Gas Law (1971), 9 Alta L. Rev. 452.

[2] *Shell Oil Co.* v. *Gibbard,* [1961] S.C.R. 725, at p. 732, 30 D.L.R. (2d) 386, 36 W.W.R. 529.

[3] It is not proposed to rehearse the intricacies of these decisions in this article, readers not overly familiar with the structure of the oil and gas lease and the judicial pronouncements on it might find it helpful to refer to my previous article in this Review, *supra,* footnote 1, where these matters are discussed in detail.

[4] *Shell Oil Co.* v. *Gunderson,* [1960] S.C.R. 424, 23 D.L.R. (2d) 81.

[5] *Shell Oil Co.* v. *Gibbard, supra,* footnote 2.

[6] *Canadian Superior Oil of California Ltd.* v. *Kanstrup and Scurry-Rainbow Oil Ltd.,* [1965] S.C.R. 92, 47 D.L.R. (2d) 1, (1964), 49 W.W.R. 257; *Canadian Superior Oil Ltd.* v. *Paddon-Hughes Development Co. Ltd. and Hambly* (1968), 65 W.W.R. 461 (Alta); (1969), 3 D.L.R. (3d) 10, 67 W.W.R. 525 (C.A.); (1970), 12 D.L.R. (3d) 247, 74 W.W.R. 356 (S.C.C.).

[7] *Canada Cities Service Petroleum Corporation* v. *Kininmonth,* [1964] S.C.R. 439, 45 D.L.R. (2d) 36, 47 W.W.R. 437.

menced within the primary term was completed and put on production ten days after the expiration of the primary term.[8]

These decisions have been roundly criticized,[9] and indeed the results which stripped one of the parties of a valuable property where he clearly had no intention of abandoning or surrendering it are somewhat disquieting. One could argue that Canadian courts might have followed the example of their American counterparts and given more weight to the intention or *bona fides* of the lessee. But the legal logic behind the decisions has been hard to fault; the results are consonant with a strict interpretation of the words used in the lease and a rigorous exclusion of all extraneous considerations. Above all, the decisions followed a consistent pattern and the parties to a challenged lease could assess their respective positions with a fair degree of accuracy. In particular, the lessee knew that if the facts betrayed the most minute time gap or slightest flaw he was in deep trouble. Then along came *Cull* v. *Canadian Superior Oil Ltd.*[10]

The *Cull* case started out innocently enough. The trial judge, Sinclair J., who by reason of his career at the Bar is particularly knowledgeable with respect to the oil industry, made a meticulous and detailed analysis of both terms of the lease and its factual background.

The relevant provisions in the lease were:

> 2. Subject to the other provisions herein contained this lease shall be for a term of ten years from this date (called "primary term") and as long thereafter as oil, gas or other mineral is produced from the said land hereunder, or as long thereafter as Lessee shall conduct drilling, mining, or re-working operations thereon as hereinafter provided and during the production of oil, gas or other mineral resulting therefrom.
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> 7. If prior to the discovery of oil or gas on said lands Lessee should drill a dry hole or holes thereon, or if after the discovery of oil or gas the production thereof should cease from any cause, this lease shall continue in force during the primary term, if on or before the rental paying date next ensuing after the expiration of ninety (90) days from date of completion of dry hole or cessation of production Lessee commences drilling or re-working operation or commences or resumes the payment or tender of rentals, or after the primary term if Lessee commences additional drilling or re-working operations within sixty (60) days from date of completion of dry hole or cessation of production, and if production results therefrom then so long as such production continues. If, during the last year of the primary term and prior to the discovery of oil or gas on said land, Lessee should drill a dry hole thereon, anything herein contained to the contrary notwithstanding, this lease shall continue in force during the remainder of

[8] *Sohio Petroleum Company* v. *Weyburn Security Company* (1970), 13 D.L.R. (3d) 340, (1970), 74 W.W.R. 626 (S.C.C.).

[9] See, for example, Currie, *op. cit.*, footnote 1, at pp. 462-463.

[10] (1970), 74 W.W.R. 324 (Alta); 75 W.W.R. 606 (C.A.); (1971), 20 D.L.R. (3d) 360, [1971] 3 W.W.R. 28 (S.C.C.).

the primary term without further payment of rentals or conduct of operations upon the leased premises, and if production be obtained as herein provided, so long as such production continues.

12. If Lessee shall commence to drill a well within the term of this lease or any extension thereof, Lessee shall have the right to drill such well to completion with reasonable diligence and dispatch, and if oil or gas be found in paying quantities, this lease shall continue and be in force with like effect as if such well had been completed within the term of years herein first mentioned.

The relevant facts were:

— The primary ten year term ended on December 30th, 1957.
— The well had been spudded on November 28th, 1957 and drilled ahead until December 23rd, 1957.
— On December 24th and 25th the well was cored and a drill stem test was run with results that led the lessee to believe the well should be completed as an oil well.
— Drilling was resumed and continued to total depth which was reached on December 28th and a radio-active log was run on the same date.
— Production casing was set on December 29th and a Christmas Tree (which is the wellhead equipment that controls production) was placed on the well.
— The drilling rig was released on December 30th, 1957 and it took two days for the rig to be dismantled and moved off the site.
— A service rig (much smaller and less expensive to operate than a drilling rig and commonly used for completion operations) was moved onto the site and rigged up on January 2nd, 1958.
— On January 3rd, it commenced completion operations including the recovery of dropped casing, the running of a radio-active log and perforations into the prospective formations. Production tubing was run and on January 6th the well was acidized—a process designed to open up the formation and increase the flow.
— On January 7th the well was swabbed, an operation where outside oil is pumped into the well to stimulate the flow of oil from the reservoir and both the introduced and formation oil began to flow and were discharged into a disposal pit. The service rig was released on the same date.
— By January 7th, 1958, the well was capable of producing oil for the first time—on this date the well had started to flow and the Christmas Tree was shut to stem the flow and the service rig released and removed from the site.
— The well could not be produced as of that date because the necessary producing equipment (a separator) and

tankage was not present on the site or connected to the well.

— On January 8th, 9th and 10th a 500-barrel tank separator and miscellaneous equipment were erected and installed.

— The well was re-opened on January 11th, 1958 and began to flow into production. Subject to the producing allowable established by the Oil and Gas Conservation Board, production in paying quantities continued ever since.

— The oil that began to flow into the tank on January 11th, was found by the court to be a mixture of outside oil which had been introduced during the swabbing operations and only partially recovered during tests and actual formation oil.

— For accounting purposes the lessee treated all of the oil produced on January 11th and 12th as paying back the load oil from other sources and treated production as having commenced on January 13th, 1958.

Having carefully dissected the facts in the case it was then necessary for the trial judge to apply them to the lease structure. Sinclair J. began with the eminently correct statement that: "The words in the lease must bear their usual and normal meaning." Looking first at clause 12 which conferred upon the lessee who had commenced to drill the well within the term the right to drill it to completion, he held that the meaning of the words "drill . . . to completion" was not broad enough to include those acts taken after January 7th when the Christmas Tree was closed and the service rig released. The trial judge found the well had been drilled to completion on January 7th, 1958 and the oil was found in paying quantities.

Parenthetically, it might be observed that by so extending the primary term, the court was following the *Hambly* decision which is the first instance in which the right to drill beyond the primary term was invoked—to no avail, as matters turned out in that case.

Clause 12 provided that under such conditions "this lease shall continue and be in force with like effect as if such well had been completed within the term of years herein first mentioned". This in turn drives one back to clause 2, the *habendum*, which provided that the lease continues after the primary term so long as "oil, gas or other mineral is produced from the said land hereunder, or as long thereafter as Lessee shall conduct drilling, mining, or re-working operations thereon as hereinafter provided and during the production of oil, gas or other mineral resulting therefrom". Certainly oil was not being produced on January 7th and was not produced until at least January 11th, and, in the words

of the court, "more probably, January 13th", so that production could not be relied upon as extending the primary term. This left only the provision "or so long thereafter as Lessee shall conduct drilling, mining, or re-working operations thereon as hereinafter provided and during the production of oil, gas or other mineral resulting therefrom". Sinclair J. traced this reference as applying only to clause 7 which allowed the lessee a period of sixty days after cessation of production following the expiration of the primary term within which to commence additional "drilling or re-working operations". In the present case of course there were no additional drilling or re-working operations commenced within sixty days after January 7th, 1958. He then concluded that the lease had terminated since the well had been drilled to completion on January 7th, 1958 and there was no production for a period of several days thereafter.

This decision was a precisely correct application of the case law to the terms of the lease. The facts disclosed there was no actual production on the date at which the primary term as extended by the drilling of a well to completion expired, namely, January 7th, 1958. There was no actual production for a period of at least four and more likely, six days following such completion. Sinclair J. did nothing more than apply clearly perceived and enunciated law. True, the result which deprives a lessee of his lease where he had been guilty of no sin or omission, other than postponing the commencement of the well until near the end of the primary term, offends against one's sense of reasonableness and fair play. But that particular bridge was crossed long ago. The result at the trial in the *Cull* case was totally predictable and consistent with the law as then revealed by the Supreme Court of Canada.

The first suggestion that an oil well might be treated differently than a gas well arose with the argument based on allowables. Unlike gas, oil production in Alberta is subject to a quota system. Broadly speaking, the total monthly market demand is distributed among the province's producing oil wells on a formula that utilizes such parameters as reserves, reservoir characteristics, deliverability, well status and other considerations. The application of this formula yields an allowable for each well which is often less than what the well could produce under normal operations. When a well has attained its quota, it is shut in for the balance of the month.

This had in fact occurred in the *Cull* case, the well was shut in for at least three days in January, 1958 (the all-important month) because its allowable had been reached. The lessee argued that since the well had produced its full quota for the month, the interruption in the flow of oil between January 7th and 11th was

of no significance. Sinclair J. found this argument to be unsound as applied to the terms of the lease. In his view the effect of the government-imposed allowable system was to create a *force majeure* so that under the applicable clause of the lease the lessee was not in breach of his obligation to continually produce the well. But he held that the protection afforded by the *force majeure* clause did not arise until the well has been produced to the point where the allowable restriction comes into play. What the trial judge seems to be saying on this point is that he would not allow what might be called an "anticipatory *force majeure*" to bridge the gap between expiration of the primary term and commencement of production.

The court, having thus extinguished the lease, resurrected it by the application of estoppel derived from a subsequent written agreement between the parties. This aspect of the judgment is discussed in the section dealing with estoppel.

So the lease when it came before the Appellate Division was one which was in full force and effect. It seems fair to assume that the hand of the lessee was strengthened by the fact that it was not necessary to revive an extinguished lease but merely to support a subsisting one. In any event the Appellate Division found that they could "keep in mind the realities of the situation and the purposes which are contemplated by the lease". The reality that had the greatest impact was the fact that the well produced and sold its full quota of oil for the month of January and the lessor received the royalty he was entitled to receive. Johnson J. A. accords the quota system a much different role than the trial judge who treated it as a *force majeure* which might become applicable if the conditions of a particular clause in the lease were met. The Appellate Division obviously considered it an important part of the general background against which the lease was to be viewed. The difference between the two approaches is profound.

A second reality lay in the fact that it was theoretically impossible to have production at the exact moment a well is completed and that the lessee had proceeded with "reasonable diligence and dispatch" to place the well on production. This is what might be termed the "time bridge" theory and it is interesting to watch it being built. If there must always be some gap, no matter how infinitesimal, between completion of a well and production the court observed that a lessee could never take advantage of a provision such as clause 12 in the Cull lease. If one assumes, as the court obviously did, that some time gap is not necessarily fatal, the question then becomes—how much of an interval is permissible? The logical answer might be what is reasonable in the circumstances—which in turn leads to the conclusion that if the lessee has proceeded in accordance with good oil field practice

and in a reasonable time and "with reasonable diligence and dispatch", the gap will be bridged.

The two circumstances, that the full allowable had been produced and the lessee had acted with reasonable dispatch and in accordance with normal practice formed the basis for distinguishing an array of authority that would have terminated the lease. There were no less than three Supreme Court of Canada decisions; *Kanstrup, Murdoch* and *Hambly,* where it had been made clear that leases would terminate if there was no production, actual or constructive, at the end of the primary term. "At the time the primary term came to an end, no oil, gas or any other mineral was being produced from any part of the unit, nor was there any gas which could be considered as being produced as a result of the operation of clause 3(b)."[11] (Clause 3(b) being the capped gas well royalty clause.) These three decisions all involved gas wells which were shut in for lack of an existing market and where the lessee permitted several days to elapse before making the capped gas well royalty payment. Such payment of course under the terms of the lease constitutes constructive production and the courts held that if the payment was not timely made the lease would terminate at the end of its primary term. The well in the *Cull* case was productive of oil and not gas, hence there could be no suggestion of constructive production, it had to be actual production or nothing. Since the well was not produced on January 7th, 1958 the conclusion that the lease had terminated would seem to be well-nigh irresistible, in the light of previously decided cases. But the Appellate Division found that the combined circumstances of the well having fulfilled its quota for the particular month and the lessee having proceeded expeditiously were sufficient to distinguish the gas well cases.

The approach of the Appellate Division was endorsed by the Supreme Court of Canada which quoted extensively from Johnson J. A.'s judgment. Martland J. agreed that the lease had not expired and adopted all comments on the effect of the quota system, good oil field practice and reasonable diligence. By these lengthy and approving quotations the Supreme Court of Canada clearly sanctioned reference to outside considerations when interpreting the lease. It is a safe understatement to remark that this approach represents a departure from the earlier treatment accorded by the Supreme Court of Canada to oil and gas leases.

The judgment becomes even more interesting when it seeks to distinguish the *Hambly* precedent. The wording of the lease in both cases was identical. As in *Cull,* the lessee in *Hambly* commenced drilling a well near the end of the primary term and the

[11] *Canadian Superior Oil of California Ltd.* v. *Kanstrup and Scurry-Rainbow Oil Ltd., supra,* footnote 6, at p. 267 (W.W.R.).

drilling continued beyond the expiration date thus extending the term by operation of clause 12. All three courts in *Hambly* held that the well had been drilled to completion on the date when the rig was released and the Christmas Tree was in position on the wellhead. The well in *Hambly* also proved to be productive, but of gas, not oil. Since gas cannot be immediately produced, the lessee made a capped gas well royalty payment which, as described above, creates a deemed or constructive production. Unfortunately for the lessee this payment was not made until a week after the well had been completed.

In rendering the *Hambly* decision, the Supreme Court of Canada observed:[12]

> The result is that, under par. 2, extension of the term of the lease depends upon there being production either at the time the primary term ends, or, if par. 12 becomes applicable, on the completion of the drilling of a well commenced before the primary term ends. In either case, failure to produce results in the termination of the lease.
> In the present case, the commencement of the drilling of the well, shortly before the expiration of the primary term, extended the term until drilling was completed [August 6th, 1958]. At that time, the term of the lease could only continue as a result of production, actual or constructive, and there was none. Accordingly the lease terminated on that date.

If one applied the reasoning contained in the above passage to the facts in *Cull* the expected result must be that the lease had terminated since there was no production on the completion date.

In the process of distinguishing the *Hambly* decision, the Supreme Court of Canada went the full distance in building the time bridge:[13]

> It ignores the added provision for continuance if the well which it authorizes to be drilled produces oil or gas in paying quantities. That provision was of no avail in the *Hambly* case, because the lessee had decided not to produce and took no further steps to produce after the well's completion. In the present case, the necessary steps were taken, with reasonable diligence and dispatch, and the well was put into production.

In passing it should be remarked that the statement that the lessee in *Hambly* had decided not to produce is an over-simplification. Since the well was a gas well with no available market the lessee in *Hambly* had no real choice or decision to make. He could not produce in any event.

The diligent efforts of the lessee to place the well on production served not only to distinguish *Hambly* but also to maintain the lease in force during the interval between completion and actual production. The Supreme Court endorsed the Appellate

[12] *Supra*, footnote 6, at p. 359 (W.W.R.).
[13] *Supra*, footnote 10, at pp. 35-36 (W.W.R.).

Division's approach that to require production immediately upon completion would deprive clause 12 of any effect. Since there must in any event be a gap, "It is sufficient, if, following completion of the well, production is obtained from it with reasonable diligence and dispatch".[14]

The *Cull* decision achieved one positive result and raised a number of implications that are not so readily defined but are, nonetheless, of great significance. The concrete result is that on the question of production at the end of the primary term, oil wells will be treated differently than gas wells. One must assume that the precedent established by *Hambly, Kanstrup* and *Murdoch,* will continue to prevail with respect to gas wells and accordingly a late payment of a suspended well royalty will be fatal. On the other hand, the lessee so long as he acts with diligence, will be permitted a reasonable length of time in which to place an oil well on production.

The distinction was constructed on the combined effect of the quota system and the assumed impossibility of placing an oil well on production immediately upon it being completed. Because of the operation of the allowable system the lessor had received the full royalty which he was entitled to for that month and accordingly had suffered no damage. But surely by the same logic the lessor of a gas well shut-in for lack of a then existing market has suffered no perceptible damage from the fact that he may have received his suspended well royalty payments a week later than a strict reading of the terms of the lease demanded.

The second ground, that there must always be some time gap between completion and production, has two sub-divisions. One is that if production were required to commence immediately upon the completion of drilling operations, a portion of clause 12 could have no effect whatever. As to this, it may be observed that the effect of depriving a clause from having any application or indeed from having an application different from that clearly intended by the parties, has not deterred the courts in the past. The second branch is that, having regard to usual oil field practice it would never be possible to have production at the exact moment the well was completed. The reference to "the exact moment" appears to be an exaggeration of what the capped gas well precedents require. It was never seriously suggested in *Kanstrup, Murdoch* and *Hambly* that the lease could be terminated so long as the necessary payment was mailed at any time during the very day on which the well had qualified. The ratio of the gas well cases would seem to yield the result that if a well drilled at the end of the primary term turns out to be productive of oil it must be placed on production on the same day in which it is completed.

[14] *Ibid.,* at p. 37.

Certainly this requires more in the way of preparedness and expedition than is the case under "usual oil field practice" but Canadian courts previously have not displayed overly much concern on this aspect of their decisions. The three gas well cases are the epitome of the approach traditionally followed by the court—a strict literalistic interpretation of the precise words of the lease. In *Cull,* however, we find the injection of considerations such as the conduct and *bona fides* of the lessee, the operation of a government production quota system, good oil field practice and a reluctance to nullify a clause in the lease, to ameliorate the result which otherwise would have been reached under the strict interpretation route. The oil industry and the legal profession can live comfortably with either approach, both have their advantages and drawbacks. Not knowing which will prevail, however, is unsettling. They do, after all, produce completely opposite results.

II. *Goodbye Estoppel.*

As leases were cut down by one strict interpretation after another the equitable doctrine of estoppel began to emerge as a potential champion of the fallen lease.

Simply put, estoppel will prevent one party from proving the true state of the legal relationship if there are circumstances which make it inequitable to permit the relationship to be proved. *Halsbury* puts it this way:[15]

> Where one has either by words or conduct made to another a representation of fact, either with knowledge of its falsehood, or with the intention that it should be acted upon, or has so conducted himself that another would, as a reasonable man, understand that a certain representation of fact was intended to be acted on, and that the other has acted on the representation and thereby altered his position to his prejudice, an estoppel arises against the party who made the representation, and he is not allowed to aver that the fact is otherwise than he represented it to be.

This might be described as the basic form of estoppel. Over the years the courts have developed refinements and variations on the theme and today four main categories are recognizable.

Estoppel by representation. The first and best known species of estoppel is essentially the doctrine described in the foregoing passage from *Halsbury.* A modern textbook buries it in this maze of commas and parenthesis:[16]

> Where one person (the representor) has made a representation to another person (the representee) in words or by acts and conduct, or (being under a duty to the representee to speak or act) by silence or inaction, with the intention (actual or presumptive), and with the result,

[15] Halsbury's Law of England (3rd ed.), Vol. 15, p. 169.

[16] Spencer, Bower and Turner, Estoppel by Representation (2nd ed., 1966), p. 4.

> of inducing the representee on the faith of such representation to alter his position to his detriment, the representor, in any litigation which may afterwards take place between him and the representee, is estopped as against the representee, from making, or attempting to establish by evidence, any averment substantially at variance with his former representation, if the representee at the proper time, and in the proper manner, objects thereto.

Estoppel by acquiescence. The evolution of the remedy of estoppel reveals a continuous process of responding to needs and requirements as they are disclosed by the facts of individual cases. Estoppel by representation had one obvious and inherent limitation; it required a positive representation of a fact. Precisely the same injurious effect may be worked upon one party if the other refrains from asserting something or taking action to establish a position and thereby leads his opposite number into a mistaken belief of the facts and a resulting act of detriment. The failure to do something when equity requires a positive reaction led to estoppel by acquiescence. If one party is to be affixed with a responsibility by reason of a failure to act or speak, equity clearly demands that he have knowledge of his position before he refrains from asserting his rights. The acquiescing party must remain silent with knowledge of the true legal position.

> 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.[17]

Promissory estoppel. The equitable remedies of estoppel by representation or by acquiescence could be invoked only if they dealt with an existing fact. As soon as they moved into the realm of

[17] *Willmott* v. *Barber* (1880), 15 Ch. D. 96, at p. 105.

the future they became ineffective as remedies. Since many promises and undertakings must involve future dealings there was an obvious lacuna. Eventually the doctrine of promissory estoppel was evolved to fill it.

> When one party has by his words or conduct made to the other party a promise or assurance which was intended to affect the legal relations between them and to be acted upon accordingly then once the other party has taken him at his word, and acted upon it the one who gave the promise or assurance cannot afterwards be allowed to revert to their previous legal relations as if no such promise or assurance had been made by him, but he must accept their legal relations subject to the qualifications which he himself has so introduced.[18]

Estoppel by deed. This species of estoppel comes into play when the parties have recognized a certain state of affairs through the execution of a written document. Estoppel by deed impinges upon the area of contract but falls short of an express agreement on the point between the parties. Instead the document must lead to the conclusion that the parties have agreed to act upon an assumed state of affairs.

> Estoppel by deed, then, arises where it appears from the formal writing of the parties that they have agreed to admit as true, or to assume the truth of, certain facts as the conventional basis upon which they have entered into contractual or other mutual relations.[19]

The usual course of events in the relationship between lessor and lessee gives rise to a host of situations that might create estoppel. This is particularly true since the lessor normally does not become aware that the lease has terminated until some time after the event and thus may continue to accept rentals and royalties, permit the lessee to conduct operations on the land, seek reimbursement for mineral taxes and generally act as though the lease were in full force and effect. Small wonder that estoppel is so appealing to the lessee as a means of restoring his shattered lease.

In recent years estoppel began to enjoy considerable success in the lower courts. The first occasion on which estoppel successfully revived a lease was at the trial decision of *Canadian Superior Oil Ltd.* v. *Murdoch.*[20] In that case the lessee drilled a well near the end of the primary term and the well proved to be capable of commercial production of gas. The lessee made a late payment of the capped gas well royalty and thus the lease terminated, although neither party appears to have realized it at the time. In the following year the lessor's husband commenced an action against the lessee claiming title to petroleum and natural gas underlying certain portions of the leased lands excepted from the

[18] Halsbury, *op. cit.*, footnote 15, Vol. 15, p. 175.
[19] Spencer, Bower and Turner, *op. cit.*, footnote 16, p. 146.
[20] (1968), 65 W.W.R. (N.S.) 473 (Alta).

title description for railway grounds and right of way. The lessee's position was that these minerals were actually the property of the wife who was the lessor and so were included under the lease. Subsequently the lessor was joined with her husband as an applicant and pleadings were ordered on the issues. A statement of claim was filed and on behalf of the lessor stated:

a) Even if she had any right to the mines and minerals under the Canadian Pacific Railway Company right of way and station grounds which she denies as the said mines and minerals were never given to her, the Petroleum and Natural Gas Lease excepted said minerals.
b) That in the further alternative, *that said lease has expired* due to the fact that ten (10) years have elapsed from the date of commencement of the lease and that Canadian Superior Oil of California Ltd. *is not engaged in drilling said land or working operations but has drilled on said land and has "capped" wells on said land* to the detriment of the Plaintiff depriving her of oil royalties. [Italics added.]

The issue as to the status of the lease was squarely raised, although one must conjecture that the lessor did not appreciate how sound her position really was. In 1961 when these matters were taking place, the Supreme Court of Canada had yet to hand down that series of decisions that terminated leases wherever there was the slightest time gap in the payment of capped gas well royalties. The dispute between the parties was eventually compromised and a settlement agreement signed under seal. Among other matters it included the following:

3. Subject to the payment of the amount set forth in Clause 3 hereof, Agnes Murdoch, for herself, her heirs, executors, administrators and assigns does hereby ratify and confirm that the said Lease is in good standing and of full force and effect.
4. Where Dower consents may be required in the agreements or documents hereinbefore referred to, Agnes Murdoch and William G. Murdoch agree to give such consents in order to carry out the true intent and purpose of this agreement.

Riley J. found that the lease had terminated because there was no actual or constructive production at the end of the primary term. This finding was virtually a foregone conclusion and, "The crux of the present matter is that of estoppel".

He quoted extensively from *Man. Assur. Co.* v. *Whitla*[21] where the plaintiff advised an insurance agent that there was prior insurance in existence but also stated that he would cancel it and on this basis took out new insurance. It was held that the new insurance was taken out on the contractually fixed understanding that the former insurance did not exist. The Supreme Court of Canada decision in the *Whitla* case contains this passage:[22]

[21] (1903), 34 S.C.R. 191.
[22] *Ibid.*, at p. 207.

> "There is nothing" says a learned text writer, "in the law to prevent parties, if they so think fit, from agreeing that, as between them, a certain fact, or state of facts, shall, for the purposes of a particular transaction, which it is competent for them to enter into, and into which they propose to enter, be taken to be true, whether it be in fact true or not, or although they know, or either of them knows, it to be untrue". That is called estoppel by contract.

Applying this form of estoppel to the facts at hand, Riley J. held:[23]

> The common sense of the matter is that it is idle to contend that the lease is not valid or that one cannot "breathe life" into an instrument already dead. That may well be true but the parties have agreed to a different fact, namely, "the lease is in good standing and of full force and effect".

The lease was maintained on appeal to the Appellate Division and the Supreme Court of Canada although both courts expressly held that it was not necessary to rely on estoppel in order to do so.[24] The settlement agreement was itself a binding contract and considered as such was sufficient to dispose of any arguments against the continued existence of the lease.

> It is, I suggest, not necessary to look beyond the agreement itself to determine the nature of the right that has been created. The preamble of the agreement recites that the parties have agreed to settle their disputes. One of these disputes concerned the continued validity of the lease. This was raised directly in the pleadings in the first action and inferentially in the other. The covenant resolves this dispute by the appellant ratifying and confirming that "the said lease is in good standing and of full force and effect". The right is contractual and I do not think it is necessary to look elsewhere for other rights which might have been created by it.[25]

Since the lease was maintained through the application of ordinary contract law, the Supreme Court of Canada was not required to address itself to the question of estoppel. One may assume, however, that its invocation by the trial judge increased its credibility as a shield for threatened leases.

Estoppel received a further shot in the arm by the trial decision in the *Cull* case[26] where estoppel by deed was called in aid of the stricken lease. The circumstances that terminated the lease have already been described. Sinclair J. having found the lease to have expired, turned to the question of estoppel. The lease did not cover all of the quarter section of land; excepted therefrom were three small parcels totalling 8.21 acres for road

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[23] *Supra,* footnote 20. at p. 483.
[24] (1969), 68 W.W.R. 390 (C.A.); (1969), 70 W.W.R. 768 (S.C.C.).
[25] *Ibid.,* 68 W.W.R., at p. 398, adopted by the Supreme Court of Canada; 70 W.W.R.. at p. 768.
[26] (1970), 74 W.W.R. 324 (Alta).

and right of way and an 18.38 acre parcel which belonged to another owner. Shortly before the well was commenced (very close to the end of the primary term of the Cull lease) the lessee obtained a lease of the 18.38 acres from the owner of that parcel. This left the 8.21 acres for road and right of way still unresolved. Furthermore the Cull lease did not contain a pooling clause. So matters rested until after the well had been placed on production. Thereafter negotiations ensued which led to an amending agreement executed on July 11th, 1958 but made effective as of November 21st, 1957—before the expiration of the primary term. This amending agreement included the 8.21 acres in the description of the leased lands and also added a pooling clause. At the time the amending agreement was entered into neither party apparently doubted the continued existence of the lease, nor did the agreement contain any express ratification of the lease except such as might be inferred from this provision:

> (5) All other terms, covenants and conditions contained in the said lease remain in full force and effect.

That statement fell short of an express covenant that the lease was subsisting, the attention of the parties had not been directed to the issue of its validity. The trial judge treated the amending agreement as an estoppel by deed. He reasoned that when the agreement was entered into the parties must have assumed that the lease was valid. "This was the conventional basis upon which they entered into the amending agreement. It is, in my opinion, unjust that the defendant Mrs. Cull, and those claiming through her, should now contend that a different state of facts exist."[27]

It will be recalled that both the Appellate Division and the Supreme Court of Canada held that there was no fatal time gap so the lease was upheld without recourse to estoppel.

So far so good, but estoppel had yet to be tested beyond the provincial Supreme Court level. Eventually the issue was considered by the Supreme Court of Canada in two cases that were heard back-to-back. In the first one, the *Hambly* case,[28] none of the courts were prepared to consider the events that had transpired as amounting to estoppel. On the other hand, the Saskatchewan Queen's Bench in the *Weyburn* case[29] found that the acts and demands of the lessor amounted to estoppel. It might be remarked with respect to the *Weyburn* case that the acts of the lessor were as positive and unequivocal as one could ever expect to encounter in oil and gas situations.

The form of lease did not contain a clause similar to clause 12

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[27] *Ibid.*, at p. 339.
[28] *Supra*, footnote 6.
[29] (1968), 66 W.W.R. 155 (Sask.).

in the *Cull* case quoted *ante* which extended the primary term to completion of a drilling well. In *Weyburn* a well was commenced just prior to the expiration of the primary term and was completed as an oil well and placed on production some eleven days after the end of the primary term. Since the primary term could not be extended to the completion of the drilling well, there was no production actual or constructive at the time the term expired. MacPherson J. applied a decision of the Supreme Court of Canada in *Canada Cities Service Petroleum Corporation* v. *Kininmonth*[30] to hold that the lease had come to an end before it went on production. This fact, however, was unrecognized by the parties at the time and the lessee produced oil and paid royalty to the lessor for a period of nearly seven years. During this period of time, the lessor:

— Accepted royalties on production.
— Demanded and received reimbursement for mineral taxes pursuant to a clause in the lease. The last such demand was made and acted upon just four days before the commencement of the trial.
— Demanded that the lessee drill an offset well pursuant to a clause in the lease. The lands included in the lease covered more than one spacing unit for oil wells and another company had drilled an oil well on adjoining lands. The offset well was in fact drilled by the lessee at a cost of approximately $49,000.00.
— Granted to the lessee a surface lease for the purpose of drilling the offset well and received $622.00 as consideration.

After making this revealing observation, "In all frankness I must confess that, the law aside, I have little sympathy for the position taken by the plaintiff." (the plaintiff being the lessor), the trial judge applied promissory estoppel to maintain the lease. In his view the promise was contained in the conduct of the lessor in making the demands under the lease and the promise was that the lessor would continue to consider the lease a good and binding agreement between the parties. "This promise must be honoured. In my view the plaintiffs are now estopped from alleging the contrary."

There were no contracts, settlement agreements or collateral deeds reflecting the belief or assumption of the parties that the lease was in force. If there was to be estoppel in *Weyburn* it could be created only from the acts and conduct of the lessor. The trial decision in the *Weyburn* case was the high water mark in estoppel's career as a saviour of oil and gas leases.

The retreat began immediately, however, with the decision of

[30] *Supra,* footnote 7.

the Court of Appeal.[31] Estoppel stumbled because it could not meet all three requirements outlined by the court, namely:

1. A representation of an existing fact;
2. Acted upon by the party to whom it was made and in the manner intended;
3. The party to whom the representation was made must have altered his position to his detriment.

The Court of Appeal did not find it necessary to resolve whether the words and conduct of the lessor amounted to a representation since it found that the lessee at no time acted upon any such words or conduct of the lessor to alter its position. The court was satisfied from the evidence that both the lessor and the lessee were of the mistaken belief that the term of the lease had been extended. All of the facts relating to the operation of the *habendum* clause were fully within the knowledge of the lessee. Hall J.A. quoted this passage from *Calvan Consolidated Oil & Gas Co.* v. *Manning*:[32]

> There was no representation made or conduct amounting to representation done by the plaintiff with the intention of inducing any conduct on the part of the defendant. Here both parties acted under a mistake — whether a mistake of law or a mistake of fact is of no consequence — and there is no question of either party having made any representation to the other. Whatever the defendant did — and his consequent action is an essential ingredient of estoppel — he did because of his own mistake and not by reason of any representation of the plaintiff.

The lessee had always believed that the lease had not terminated and its position was adopted prior to and apart from any alleged representation on the part of the lessor. Therefore estoppel by representation or even promissory estoppel could not be applied because the second test was not met. The actions taken by the lessee in procuring a surface lease, drilling the offset well, paying royalties and reimbursing mineral taxes were taken because the lessee mistakenly believed the lease was in force. This treatment of estoppel was approved on appeal to the Supreme Court of Canada, but before commenting on that decision, it is necessary to back-track and review the *Hambly* case.

The acts and conduct that were relied upon in *Canadian Superior Oil Limited* v. *Paddon-Hughes Development Co. Ltd. and Hambly*[33] were much less impressive than those in *Weyburn*. The Hambly lease had been terminated because the payment of the capped gas well royalty was late but this fact was not appreciated

[31] (1969), 7 D.L.R. (3d) 277, 69 W.W.R. 680 (C.A.).
[32] (1957), 22 W.W.R. 433, at p. 453 (Alta); rev'd (1958), 25 W.W.R. 641 (C.A.).
[33] *Supra,* footnote 6.

by either party at the time. The lessee sought to invoke estoppel but the only evidence he could muster in support was:

— Payment and receipt of shut-in royalties during the years 1958 to 1965. These payments were made to a trust company under royalty trust agreements executed by the lessor in 1951. The trust agreements required the trust company to receive the royalty income and distribute it among the certificate holders. There were only two distributions made by the trust company and the lessor returned his share of the second one.
— Rental payments received and retained by the lessor pursuant to a surface lease.
— The employees of the lessee would ask for and obtain the consent of the lessor to enter upon the lands whenever they wished to check the status of the well or perform any work on it.
— In May 1960, the lessor noticed that a well pressure gauge was dangerously high and informed the lessee.
— The lessor by way of collateral security to a mortgage executed an agreement which assigned to the mortgage company "all bonuses, rentals, delay rentals and other considerations and benefits" payable under certain leases and surface leases which were listed and included a description of the subject lease.

The trial judge found there was no basis for estoppel. He did not elaborate but clearly felt that the acts could not constitute a representation and also that the lessee had not proved any detriment.

The Appellate Division made a more extensive examination of estoppel and reviewed both estoppel by acquiescence and by representation. The former was discarded since knowledge of his legal rights must be established on the part of the person against whom estoppel is alleged. As the court pointed out Hambly did not know that he had the right to treat the lease as having been terminated. "It was only after two parties had tried to obtain copies of his lease that he began to suspect that something might be wrong." Estoppel by representation through words and conduct was denied on the basis that the events listed above could not amount to a representation on the part of the lessor.

The *Hambly* case was heard and decided by the Supreme Court of Canada just prior to *Weyburn*. The circumstances of *Hambly* were much less persuasive than *Weyburn*, when it came to creating an estoppel against the lessor, nonetheless, the court took the occasion in *Hambly* to make several far-reaching pronouncements. The first of these, and probably the most significant in oil and gas cases, dealt with the point in time at which the

estoppel took place. The court emphasized the fact that the alleged acts of estoppel occurred after the lease had terminated.

> Without attempting finally to determine the matter, I have serious doubt as to whether the issue of estoppel can properly be raised in the circumstances of this case. The appellants, as plaintiffs, seek a declaration that the lease is a good, valid and subsisting lease. For the reasons already given, it appears that the lease in question had terminated. It could not be revived thereafter except by agreement, for consideration, between the parties. To say that subsequent representations by Hambly could recreate the legal relations between the parties would be to say that such representations could create a new cause of action for Superior. But, subject to the equitable rule as to acquiescence, which has sometimes been described as estoppel by acquiescence, and to which I will refer later, a cause of action cannot be founded upon estoppel.[34]

This passage was followed by a statement of the most current view by the Supreme Court on promissory estoppel:[35]

> . . . it is the first principle upon which all Courts of Equity proceed, that if parties who have entered into definite and distinct terms involving certain legal results — certain penalties or legal forfeiture — afterwards by their own act or with their own consent enter upon a course of negotiation which has the effect of leading one of the parties to suppose that the strict rights arising under the contract will not be enforced, or will be kept in suspense, or held in abeyance, the person who otherwise might have enforced those rights will not be allowed to enforce them where it would be inequitable having regard to the dealings which have thus taken place between the parties.

Martland J. then said:[36]

> This principle assumes the existence of a legal relationship between the parties when the representation is made. It applies where a party to a contract represents to the other party that the former will not enforce his strict legal rights under it. In the present case, however, the contractual relationship between the parties had come to an end before any representation is alleged to have been made. There is no allegation that Hambly, while the lease still subsisted, had ever represented that its provisions would not be enforced strictly.

If Martland J.'s statement means what it appears to mean, estoppel by representation or promissory estoppel are virtually excluded from any effective role in the law of oil and gas leases. If the representations must occur "while the lease still subsisted" the normal fact pattern surrounding oil and gas leases can never give rise to a successful plea of estoppel. The acts and conduct of the lessor will, in almost every instance that one can envisage, take place at a time subsequent to the termination of the lease.

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[34] *Ibid.*, at pp. 360 (W.W.R.), 251 (D.L.R.).

[35] *Conwest Exploration Co. Ltd.* v. *Letain*, [1964] S.C.R. 20, at p. 28, 41 D.L.R. (2d) 198, at p. 206 wherein the court adopted the statement (quoted in the text) by Lord Cairns in *Hughes* v. *Metro Ry.* (1877), 2 App. Cas. 439, 46 L.J.Q.B. 53.

[36] *Supra*, footnote 6, at pp. 360-361 (W.W.R.), 252 (D.L.R.).

The Supreme Court having dealt a mortal blow to estoppel by representation and promissory estoppel, turned its attention to estoppel by acquiescence. It quoted that passage from *Willmott* v. *Barber*[37] which appears *ante* under the heading *Estoppel by acquiescence.*

This definition outlines various elements that must be present before estoppel by acquiescence is created. As soon as one attempts to transpose these ingredients into oil and gas terms it quickly becomes apparent that this type of estoppel is not destined to play a starring role in the law of oil and gas leases. The *Willmott* v. *Barber* test would require the lessor to know that the lease has terminated and the lessee to be unaware of the true legal position. It is virtually impossible to affix the lessor with knowledge that the lease has terminated; if either party is knowledgeable enough to be aware of the fact, it will most likely be the lessee. Nearly every case on oil and gas leases requires three levels of the judiciary to puzzle over whether or not a lease has in fact terminated and it is hard to believe that a lessor would be attributed a degree of prescience greater than that of the courts.

Returning to the *Weyburn* case, we find the Supreme Court of Canada agreeing with the Saskatchewan Court of Appeal that the actions of the lessee did not result from representations or conduct of the lessor. The actions of the lessee were taken because the lessee, as well as the lessor, was unaware of the fact that the lease had come to an end. In these circumstances estoppel could not be established.

In rendering the *Weyburn* decision, Martland J. summed up the doubts which he had expressed in *Hambly.*[38]

> In *Can. Superior Oil Ltd.* v. *Hambly* (1970), 74 W.W.R. 356, affirming (1969), 67 W.W.R. 525, 3 D.L.R. (3d) 10, I expressed doubt as to whether a lease, which had terminated, could be subsequently enforced on the basis of representations or conduct occurring after its termination, unless, at least, they would amount to fraud, ...

The court has not made a final determination on this point since the ingredients of estoppel were held not to have been established in both *Hambly* and *Weyburn.* It looks, however, as if the only instances in which estoppel can revive a lease are: (a) when the parties have expressly agreed in writing that the lease is subsisting—this is more a matter of contract than of estoppel, and (b) when there is what amounts to fraud on the part of the lessor. Fraud in this context must contain the elements listed in the passage from *Willmott* v. *Barber,* namely: (a) a belief on the part of the lessee that the lease was in force; (b) an act or expenditure by the lessee as a result of his mistaken belief; (c)

[37] *Supra,* footnote 17.
[38] *Supra,* footnote 8, at p. 629 (W.W.R.).

knowledge on the part of the lessor that the lease has terminated; (d) knowledge on the part of the lessor that the lessee mistakenly believes the lease to be in force; and (e) either a deliberate failure of the lessor to assert the fact that the lease has terminated or direct assurance by the lessor that the lease has not terminated. It is obvious that these requirements cannot be fulfilled under the circumstances of an oil and gas lease. The Supreme Court of Canada appears ready to totally reject estoppel as a means of reviving a lease.

And this, I suggest, is precisely the way it should be. Estoppel is not an appropriate remedy to implement between an oil and gas lessee and lessor. The contractual and property relationships between the parties to lease are intricate and ongoing. There are continuing obligations and duties between the parties that cover all aspects of exploring for and producing the leased substances. There can be no justification for penalizing a lessor who innocently and mistakenly conducts himself as though the lease were in force; his compliance with what he believes to be existing obligations should not prevent him from asserting his true legal rights when he becomes aware of them.

The probable rejection of estoppel is completely in keeping with the traditional approach of the Supreme Court. This court, ever since it was first confronted with the American-derived lease, has elected to treat it as a document creating an interest in land and one which must be interpreted strictly and literally.

But the same cannot be said of the *Cull* case. With its invocation of matters extraneous to the lease, *Cull* poses an intriguing question as to the future direction to be taken by the court. As leases continue to pass in review, will *Cull* become a mere aberration confined to oil well situations, or the harbinger of an entirely new and more liberal approach to the lease?