TAB 3

Most Negative Treatment: Application/Notice of Appeal
Most Recent Application/Notice of Appeal: EnCana Midstream and Marketing v. IFP Technologies (Canada) Inc. | 2017 CarswellAlta 1669, [2017] S.C.C.A. No. 303 | (S.C.C., Aug 25, 2017)

2017 ABCA 157
Alberta Court of Appeal

IFP Technologies (Canada) Inc. v. EnCana Midstream and Marketing

2017 CarswellAlta 1133, 2017 ABCA 157, [2017] 12 W.W.R. 261, [2017] A.W.L.D. 3423, [2017] A.W.L.D. 3424, [2017] A.W.L.D. 3448, [2017] A.W.L.D. 3756, [2017] A.W.L.D. 3757, [2017] A.J. No. 666, 280 A.C.W.S. (3d) 752, 53 Alta. L.R. (6th) 96, 70 B.L.R. (5th) 173

IFP Technologies (Canada) Inc. (Appellant) and EnCana Midstream and Marketing, PanCanadian Resources, EnCana Corporation, EnCana Oil & Gas Developments Ltd., Canadian Forest Oil Ltd. and The Wiser Oil Company (Respondents)

Catherine Fraser C.J.A., Jack Watson, Patricia Rowbotham JJ.A.

Heard: October 16, 2015; November 10, 2015
Judgment: May 26, 2017
Docket: Calgary Appeal 1401-0235-AC

Proceedings: reversing *IFP Technologies (Canada) Inc. v. Encana Midstream and Marketing* (2014), 2014 CarswellAlta 1423, 591 A.R. 202, 2014 ABQB 470, Neil Wittmann C.J.Q.B. (Alta. Q.B.)

Counsel: P. Edwards, R. de Waal, for Appellant
G.N. Stapon, Q.C., L.M. Gill, for Respondents

Subject: Contracts; Evidence; Natural Resources
Related Abridgment Classifications
Contracts
VII Construction and interpretation
VII.4 Resolving ambiguities
VII.4.e Miscellaneous
Natural resources
III Oil and gas
III.6 Exploration and operating agreements
III.6.h Damages for breach
Natural resources
III Oil and gas
III.6 Exploration and operating agreements
III.6.k Miscellaneous
Headnote
Contracts --- Construction and interpretation — Resolving ambiguities — Miscellaneous
Plaintiff I Inc., research and development company, entered into deal with defendant PCR, Canadian oil and gas over plans to jointly work on enhanced recovery technology at site — I Inc. was granted 20 per cent working interest in asset exchange agreement ("AEA") — Joint operating agreement ("JOA"), attached as schedule, specified that working interest was limited to enhanced recovery — Economics of gas development changed, and PCR had to establish economically pro[illegible]

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to prevent expiry of leases — PCR entered into agreement with defendant W Co., for it to act as operator on site, dealing with existing wells and taking over working interest — I Inc. waived its right of first refusal but refused to consent to transaction — I Inc. brought action against defendants for breach of agreement — Action dismissed — Trial judge held that joint operating agreement did not supersede asset exchange agreement — Trial judge ruled that working interest was not defined in asset exchange agreement — Trail judge found that provision in JOA, stating that working interest was limited to thermal and other enhanced recovery, was not conflict but rather provided definition — Trial judge held that under agreements, I Inc.'s working interest was always limited to thermal and other enhanced recovery methods — I Inc. appealed — Appeal allowed — Trial judge erred in law in failing to recognize that "working interest" was legal term of art with specific meaning in oil and gas industry — Trial judge disregarded in their entirety clear, compelling substantive provisions in AEA relating to 20 per cent of PCR's working interest that PCR conveyed to I Inc. — Trial judge wrongly relied on preamble provision in AEA to trump its substantive textual provisions — This led the trial judge into further errors and, in end, it led him to interpretation of the contract that would have given I Inc. not only interest incompatible with parties' objective intentions but one incompatible with law on working interests in oil and gas industry — Trial judge erred in finding that I Inc. acted unreasonably in withholding its consent to farmout to W Co. I Inc.'s withholding of consent was reasonable in circumstances of this case — Accordingly, PCR breached contract by proceeding as it did.

Natural resources --- Oil and gas — Exploration and operating agreements — Miscellaneous

Plaintiff I Inc., research and development company, entered into deal with defendant PCR, Canadian oil and gas over plans to jointly work on enhanced recovery technology at site — I Inc. was granted 20 per cent working interest in asset exchange agreement ("AEA") — Joint operating agreement ("JOA"), attached as schedule, specified that working interest was limited to enhanced recovery — Economics of gas development changed, and PCR had to establish economically producing wells on site to prevent expiry of leases — PCR entered into agreement with defendant W Co., for it to act as operator on site, dealing with existing wells and taking over working interest — I Inc. waived its right of first refusal but refused to consent to transaction — I Inc. brought action against defendants for breach of agreement — Action dismissed — Trial judge held that agreements did not prohibit and actually contemplated primary production, and did not require PCR to undertake enhanced recovery operations — Trial judge found that I Inc. was unreasonable in withholding its consent to agreement between defendants — Trial judge ruled that I Inc. retained its 20 per cent working interest in thermal and other enhanced recovery at property and did not establish that its working interest was destroyed by primary operations — I Inc. appealed — Appeal allowed — Law is clear that "working interest" in relation to mineral substances in situ is particular kind of property right or interest in land — When owner of minerals in situ leases right to extract these minerals, right to extract is known as "working interest" — "Working interest" constitutes percentage of ownership that owner has to explore, drill and produce minerals from lands in question — Trial judge erred in concluding that because primary production was not expressly prohibited, it followed that reactivating primary production, including through new wells, was permitted without limitation — I Inc.'s working interest remained undivided interest tenant in common equal to 20 per cent of PCR's working interest in site's petroleum and natural gas rights and in PCR miscellaneous interests in site, as both terms were defined in AEA — I Inc.'s withholding of consent was reasonable in circumstances of this case — Accordingly, PCR breached contract by proceeding as it did.

Natural resources --- Oil and gas — Exploration and operating agreements — Damages for breach

Plaintiff I Inc., research and development company, entered into deal with defendant PCR, Canadian oil and gas over plans to jointly work on enhanced recovery technology at site — I Inc. was granted 20 per cent working interest in asset exchange agreement ("AEA") — Joint operating agreement ("JOA"), attached as schedule, specified that working interest was limited to enhanced recovery — Economics of gas development changed, and PCR had to establish economically producing wells on site to prevent expiry of leases — PCR entered into agreement with defendant W Co., for it to act as operator on site, dealing with existing wells and taking over working interest — I Inc. waived its right of first refusal but refused to consent to transaction — I Inc. brought action against defendants for breach of agreement — Action dismissed — Trail judge held that I Inc. was unreasonable in withholding its consent to agreement between defendants — Trial judge ruled that I Inc. retained its 20 per cent working interest in thermal and other enhanced recovery at property and did not establish that its working interest was destroyed by primary operations — Trial judge held that accumulation of errors by I Inc.'s experts was such that valuation based on their evidence could not accepted and that any figure selected for damages would be guess unsupported by method, principle or evidence — Trial judge held that I Inc. was never in position to realize upon its working interest, and there was no chance of thermal development at site within reasonable time of alleged breach of contract — I Inc. appealed — Appeal allowed

on other grounds — Despite breach of contract when PCR transferred its interest to W Co., I Inc. merely lost opportunity to convince PCR that thermal project should be "go" — Realistically, having regard to all relevant considerations and factors, trial judge's conclusion that there was no chance thermal project would be implemented was correct — Therefore, trial judge made no reviewable error in concluding that any award of damages should be discounted by 100 per cent to reflect chance of non-occurrence of thermal project.

The plaintiff I Inc., a research and development company, entered into a deal with the defendant PCR, a Canadian oil and gas partnership, over plans to jointly work on enhanced recovery technology at a property in Alberta ("site"). The deal made between PCR and I Inc. involved a number of agreements. There was a Memorandum of Understanding ("MOU") and a formal Asset Exchange Agreement ("AEA)". Attached to the AEA as schedules were a number of agreements, including a Joint Operating Agreement ("JOA").

I Inc. was granted a 20 per cent working interest in the AEA.The JOA specified that a working interest was limited to enhanced recovery. PCR had to establish economically producing wells on site to prevent the expiry of leases. PCR entered into an agreement with the defendant W Co. for it to act as operator on site, dealing with existing wells and taking over the working interest. I Inc. waived its right of first refusal but refused to consent to the transaction. I Inc. brought an action against the defendants for breach of agreement. The action was dismissed.

The trial judge ruled that "working interest" was not defined in the AEA and that the provision in the JOA stating that working interest was limited to thermal and other enhanced recovery, was not in conflict but rather provided the definition. The trial judge held that under the agreements, I Inc.'s working interest was always limited to thermal and other enhanced recovery methods. I Inc. appealed.

Held: The appeal was allowed.

Per Fraser C.J.A. (Rowbotham J.A. concurring) The term "working interest" has an accepted meaning and usage in the oil and gas industry sector Its interpretation has precedential value, therefore it must be interpreted consistently. While a legal term of art may be modified by the parties to an agreement, that does not permit a trial judge to ignore the meaning attributable to it in the absence of such modification. To do so is tantamount to failing to take into account a key term of a contract or relevant factor or ignoring applicable principles and governing authorities. That is a question of law reviewable for correctness.

In a recent contractual interpretation case, the Supreme Court of Canada clarified that courts ought to "have regard for the surrounding circumstances of the contract — often referred to as the factual matrix — when interpreting a written contract." While the factual matrix cannot be used to craft a new agreement, a trial judge must consider it to ensure the written words of the contract are not looked at in isolation or divorced from the background context against which the words were chosen. An antecedent agreement like the MOU, which was agreed to in writing by both PCR and I Inc., fell within the category of objective evidence of background facts. Netiations preceding the conclusion of the MOU were also relevant to the extent that they shed light on the factual matrix.

The AEA referred to PCR's conveying to I Inc. 20 per cent of PCR's "working interest" in the site. "Working interest", as that term was used in the AEA, had a specific legal meaning. Unfortunately, the trial judge failed to recognize this, then compounded this error by wrongly using the fact that the parties had not expressly defined the meaning of "working interest" in the AEA to disregard, in their entirety, the textually explicit conveyance articles in the AEA.

The fact that the AEA did not expressly define the term "working interest" was irrelevant, since it is a legal term of art. The law is clear that a "working interest" in relation to mineral substances *in situ* is a particular kind of property right or interest in land. When the owner of minerals *in situ* leases the right to extract these minerals, the right to extract is known as a "working interest." Simply stated, "working interest" constitutes the percentage of ownership that an owner has to explore, drill and produce minerals from the lands in question.

The trial judge found that the JOA was determinative of the nature and extent of I Inc.'s working interest in the site. In so finding, however, the trial judge failed to consider surrounding circumstances on the basis the contract was not ambiguous. This interpretive approach constituted a reviewable error of law. Had the surrounding circumstances been taken into account, it would have been apparent that the JOA was not intended to, and did not, limit I Inc.'s working interest in the site.

The incontrovertible facts, as revealed in the supporting documentary evidence, confirmed that PCR and I Inc. agreed, following negotiations between the parties, that I Inc. would receive 20 per cent of PCR's working interest in all development in the site. That agreement, documented in the MOU, did not limit I Inc.'s interest in the site to thermal or enhanced production only. In ignoring this factual matrix, the trial judge also relied on Article 7.3 of the AEA, which provided that the AEA "supercedes

all other agreements, documents, writings, and verbal understandings among the Parties relating to the subject matter hereof and expresses the entire understanding of the Parties with respect to the subject matter hereof." On this basis, the trial judge effectively dismissed the MOU and other surrounding circumstances as irrelevant to the interpretive exercise. In so doing, he erred.

The mere existence of an "entire agreement" provision does not mean that the words chosen beyond that entire agreement provision admit of one interpretation only. The purpose of considering the surrounding circumstances is not to add to, contradict or vary the terms of the agreement but rather use them as an interpretive aid to determine the meaning of the words in dispute. Where parties have concluded an agreement and a court is left to sort out the parties' objective intentions, it cannot be prevented from considering the surrounding circumstances by a provision that is itself based on the assumption that the agreement is clear when it is not.

The trial judge failed to recognize that the AEA and the JOA served fundamentally different objectives. The AEA dealt with ownership of the assets. The JOA outlined the terms under which the parties would operate to exploit those assets.

The record was replete with evidence that both PCR and I Inc. considered primary production to be finished at the site. The JOA did not address the terms and conditions under which primary production could be restarted or initiated without I Inc.'s agreement. Consequently, the trial judge erred in concluding that because primary production was not expressly prohibited, it followed that reactivating primary production, including through new wells, was permitted without limitation and in further concluding that W Co. did no more than PCR was entitled to do when it reactivated primary production at the site.

I Inc.'s working interest remained an undivided interest as a tenant in common equal to 20 per cent of PCR's working interest in the site's petroleum and natural gas rights and in the PCR miscellaneous interests in the site, as both terms were defined in the AEA.

The trial judge erred in finding that I Inc. acted unreasonably in withholding its consent to the farmout to W Co. I Inc.'s withholding of consent was reasonable in the circumstances of this case. Accordingly, PCR breached the contract by proceeding as it did.

The JOA did not obligate PCR to implement a thermal project. Corporate priorities, financial circumstances and the economy can all change, but that does not end the analysis. The trial judge failed to consider whether there was nevertheless, at a minimum, a reasonable expectation that PCR would not engage in primary production in a manner that substantially nullified the contractual objectives or caused significant harm. Having regard to the entirety of the contract and the factual matrix, such an expectation was a reasonable one.

Despite the breach of contract when PCR transferred its interest to W Co., I Inc. merely lost an opportunity to convince PCR that a thermal project should be a "go" and an opportunity to agree with PCR on other methods to exploit the minerals at the site. Realistically, having regard to all relevant considerations and factors, the trial judge's conclusion that there was no chance a thermal project would be implemented was correct. Therefore, the trial judge made no reviewable error in concluding that any award of damages should be discounted by 100 per cent to reflect the chance of non-occurrence of a thermal project.

Per Watson J.A. (dissenting): The trial judge's reasons properly accepted that the onus was on PCR to prove consent was unreasonably withheld. It was not a palpable error to find that I Inc.'s rationale for refusing consent was unreasonable because it had the effect of overriding legitimate rights of another party to the same deal. There was no reasonable refusal under the terms of the deal. As a matter of law, I Inc. was in no worse position after the farm-out to W Co. than it was before. PCR was under no obligation to develop the thermal and enhanced recovery potential of the site. I Inc. did not contract for that obligation.

If a reasonable reading of the deal did not support the sort of veto that I Inc. asserted could be based on its reasonable expectations, a veto could not be grounded in reasonable expectations in law. Reasonable expectations of persons involved in a specific industry (industry expectations) may also have a role in assessing whether an ambiguous clause or term of a contract should be given a specific meaning. Such expectations are not subjective. In a sense, reasonable expectations grounded in the practice of the relevant industry may be circumstantial evidence of what would be the likely objective meaning of the clause or term and therefore its case-specific meaning.

The trial judge's finding of that there was no breach of the deal was reasonable.

The appeal should be dismissed.

Table of Authorities

Cases considered by *Catherine Fraser C.J.A.*:

A. Goal of Contractual Interpretation

79 I now turn to a brief overview of the applicable principles of contractual interpretation. The goal of contractual interpretation is to determine the objective intent of the parties at the time the contract was made through the application of legal principles of interpretation: *Sattva*, *supra* at para 49. To this end, "the exercise is not to determine what the parties subjectively intended but what a reasonable person would objectively have understood from the words of the document read as a whole and from the factual matrix": Geoff R. Hall, *Canadian Contractual Interpretation Law*, 2nd ed (Markham: LexisNexis, 2012) at 33 [Hall]. Accordingly, disputed contractual terms must be interpreted, not in isolation, but in light of the contract as a whole: *Tercon Contractors Ltd. v. British Columbia (Minister of Transportation & Highways)*, 2010 SCC 4 (S.C.C.) at para 64, [2010] 1 S.C.R. 69 (S.C.C.).

1. Requirement to Consider Factual Matrix

80 One aspect of the current law on contractual interpretation engaged by this appeal relates to the relevance of the factual matrix. In *Sattva*, the Supreme Court finally clarified that courts ought to "have regard for the surrounding circumstances of the contract — often referred to as the factual matrix — when interpreting a written contract" (para 46). Why? As the Supreme Court noted, "ascertaining contractual intention can be difficult when looking at words on their own, because words alone do not have an immutable or absolute meaning" (para 47).

81 Considering the surrounding circumstances of a contract does not offend the parol evidence rule. That rule precludes admission of evidence outside the words of the written contract that would add to, subtract from, vary, or contradict a contract. However, evidence of surrounding circumstances is not used for this purpose but rather as an *objective* interpretive aid to determine the meaning of the words the parties used: *Sattva*, *supra* at paras 59-61. Therefore, while the factual matrix cannot be used to craft a new agreement, a trial judge must consider it to ensure the written words of the contract are not looked at in isolation or divorced from the background context against which the words were chosen. The goal is to deepen the trial judge's understanding of the mutual and objective intentions of the parties as expressed in the words of the contract. This approach is in keeping with Lord Steyn's famous admonition in *R. (on the application of Daly) v. Secretary of State for the Home Department*, [2001] UKHL 26 (Eng. H.L.) at para 28 that "[i]n law context is everything".

82 Thus, in interpreting a contract, a trial judge must consider the relevant surrounding circumstances even in the absence of ambiguity: Hall, *supra* at 24-25; John D. McCamus, *The Law of Contracts*, 2nd ed (Toronto: Irwin Law, 2012) at 751 [McCamus]; *Bighorn*, *supra* at para 10; *Seven Oaks Inn Partnership v. Directcash Management Inc.*, 2014 SKCA 106 (Sask. C.A.) at para 13, (2014), 446 Sask. R. 89 (Sask. C.A.); *Nexxtep Resources Ltd. v. Talisman Energy Inc.*, 2013 ABCA 40 (Alta. C.A.) at para 31, (2013), 542 A.R. 212 (Alta. C.A.) [*Nexxtep*], citing *Dumbrell v. Regional Group of Cos.*, 2007 ONCA 59 (Ont. C.A.) at para 54, (2007), 85 O.R. (3d) 616 (Ont. C.A.); *Hi-Tech Group Inc. v. Sears Canada Inc.*, 2001 CanLII 24049 at para 23, (2001), 52 O.R. (3d) 97 (Ont. C.A.) [*Hi-Tech*]; *Eco-Zone Engineering Ltd. v. Grand Falls-Windsor (Town)*, 2000 NFCA 21 (Nfld. C.A.) at para 10, (2000), 5 C.L.R. (3d) 55 (Nfld. C.A.).

83 Determining what constitute properly surrounding circumstances is a question of fact. As to what is meant by surrounding circumstances, this consists of "objective evidence of the background facts at the time of the execution of the contract ... that is, knowledge that was or reasonably ought to have been within the knowledge of both parties at or before the date of contracting": *Sattva*, *supra* at para 58. Examples of relevant background facts include: (1) the genesis, aim or purpose of the contract; (2) the nature of the relationship created by the contract; and (3) the nature or custom of the market or industry in which the contract was executed: *Sattva*, *supra* at paras 47-48; *Geoffrey L. Moore Realty Inc. v. Manitoba Motor League*, 2003 MBCA 71 (Man. C.A.) at para 15, (2003), 173 Man. R. (2d) 300 (Man. C.A.); *King v. Operating Engineers Training Institute of Manitoba Inc.*, 2011 MBCA 80 (Man. C.A.) at para 72, (2011), 270 Man. R. (2d) 63 (Man. C.A.); *Ledcor*, *supra* at paras 30, 106. Ultimately, the surrounding circumstances can include "absolutely anything which would have affected the way in which the language of the document would have been understood by a reasonable man": *Sattva*, *supra* at para 58, citing Lord Hoffman in *Investors Compensation Scheme Ltd. v. West Bromwich Building Society* (1997), [1998] 1 W.L.R. 896 (U.K. H.L.) at 913.

84 All this being so, it will be obvious why the factual matrix, that is surrounding circumstances, of a contract can be critical to understanding the objective intentions of the parties. That is certainly so in interpreting the Contract between PCR and IFP. Of particular relevance on this appeal are the genesis and purpose of the Contract and the relevant background, including the MOU. An antecedent agreement like the MOU, which has been agreed to in writing by both PCR and IFP, falls within the category of objective evidence of background facts.

85 Negotiations preceding the conclusion of the MOU are also relevant to the extent that they shed light on the factual matrix. It is true that evidence of negotiations is not itself admissible as part of the factual matrix: Hall, *supra* at 29; *Keephills Aggregate Co. v. Riverview Properties Inc.*, 2011 ABCA 101 (Alta. C.A.) at para 13, (2011), 44 Alta. L.R. (5th) 264 (Alta. C.A.) [*Keephills*]. Nor generally are prior drafts of an agreement: *Wesbell Networks Inc. (Receiver of) v. Bell Canada*, 2015 ONCA 33 (Ont. C.A.) at para 13, (2015), 248 A.C.W.S. (3d) 820 (Ont. C.A.). However, evidence of negotiations is relevant insofar as that evidence *shows* the factual matrix, for example by helping to explain the genesis and aim of the contract: Hall, *supra* at 30, 80; *Nexxtep*, *supra* at para 32. Moreover, written evidence of those negotiations is far more objective evidence of the parties' intentions than after-the-fact evidence from opposing parties about oral statements made during negotiations.

2. Admissibility of Parol Evidence to Resolve Ambiguity

86 Further, where a contract itself is ambiguous, extrinsic evidence, that is parol evidence, may be admitted to resolve the ambiguity: Hall, *supra* at 59; McCamus, *supra* at 205; *Paddon-Hughes Development Co. v. Pancontinental Oil Ltd.*, 1998 ABCA 333 (Alta. C.A.) at para 28, (1998), 223 A.R. 180 (Alta. C.A.) [*Paddon Hughes*]; *Guaranty Properties Ltd. v. Edmonton (City)*, 2000 ABCA 215 (Alta. C.A.) at para 23, 261 AR 376; *Nexxtep*, *supra* at para 20. In the face of ambiguity, the interpretation promoting business efficacy is to be preferred so long as it is supported by the text: *Keephills*, *supra* at para 12; Hall, *supra* at 38-47.

87 Mere difficulty in interpreting a contract is not the same as ambiguity: *Paddon Hughes*, *supra* at para 29. A contract is ambiguous when the words are "reasonably susceptible of more than one meaning": *Hi-Tech*, *supra* at para 18. An ambiguity in the contract also allows courts to consider evidence of the parties' subsequent conduct post-contract: *Shewchuk v. Blackmont Capital Inc.*, 2016 ONCA 912 (Ont. C.A.) at paras 46, 56, (2016), 404 D.L.R. (4th) 512 (Ont. C.A.); Hall, *supra* at 83-85. But it must be understood that even under this ambiguity exception to the parol evidence rule, there are limitations as to what parol evidence is admissible. In this regard, evidence as to the parties' subjective intentions is generally inadmissible.

3. Interpreting Commercial Contracts

88 Also of particular importance on this appeal, commercial contracts should be interpreted in accordance with sound commercial principles and good business sense: McCamus, *supra* at 763-766. In the absence of evidence of a bad bargain, courts should not interpret a contract in a way that yields an unrealistic or absurd result.

B. Conclusion

89 In the end, contractual interpretation is not an exercise in second guessing what could have been included in a contract while discounting or dismissing relevant terms of a contract and uncontradicted contextual information. It is instead an exercise in determining what the parties objectively intended having regard to the entire written text, relevant contextual background and commercial context.

VI. Analysis

A. Overview of IFP's Interest in Eyehill Creek

90 Following a careful and comprehensive review of the QB Reasons and all relevant documentation, I have concluded that the Trial Judge erred in concluding that the Contract gave IFP a 20% interest in thermal and enhanced recovery methods only at Eyehill Creek. In my view, the Contract reveals that PCR agreed to transfer, and did transfer, to IFP 20% of PCR's working interest in all the assets held by PCR in Eyehill Creek, including both Crown oil and gas leases and [illegible] PCR

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