CITATION: Tribute Resources Inc. v. McKinley Farms Ltd., 2010 ONCA 392
DATE: 20100602
DOCKET: C50782

COURT OF APPEAL FOR ONTARIO

Armstrong, Lang and Juriansz JJ.A.

BETWEEN

Tribute Resources Inc.

Applicant (Appellant)

and

McKinley Farms Ltd.

Respondent (Respondent in Appeal)

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McKinley Farms Ltd.

Applicant (Respondent in Appeal)

and

Tribute Resources Inc.

Respondent (Appellant)

Christopher A. Lewis, for the appellant

Jed Chinneck and William Mitches, for the respondent

Heard: January 26, 2010

On appeal from the judgment of Justice T. David Little of the Superior Court of Justice dated June 29, 2009.

Juriansz J.A.:

[1] Tribute Resources Inc. (“Tribute”) appeals from the dismissal of its application to declare valid two leases: an Oil and Gas Lease and a Gas Storage Lease. The same judgment granted the respondent, McKinley Farms Ltd. (“McKinley”), declarations that these leases were terminated. At issue in this appeal is the validity of the two leases.

[2] For the reasons that follow, I would allow the appeal in part. I would find the Oil and Gas Lease is valid and subsisting, but that the Gas Storage Lease terminated.

A. FACTS

[3] Tribute, through its predecessor, executed an Oil and Gas Lease with the predecessor of McKinley Farms Inc. (“McKinley”) on October 12, 1977, by which McKinley leased certain oil and gas rights to Tribute for annual rental payments. The term of the Oil and Gas Lease was “ten years and so long thereafter as oil or gas are produced in paying quantities, or storage operations are being conducted”.

[4] The Oil and Gas Lease was amended by a Unit Operating Agreement dated October 30, 1984. Paragraph three of the Unit Operating Agreement dealt with payments to be made by Tribute to McKinley “in lieu of all payments under the said lease”. One of the payments required to be made or tendered was an annual rental payment of $2.50 for every acre of the lands retained by Tribute. Section 3(b) of the Unit Operating Agreement provided, in part, as follows:

> And as long as the payments in this clause provided are made or tendered, operations for the production of the leased substances from the unit area shall be deemed to be conducted by the lessee on the said lands under the said lease, and the said lease as hereby amended shall remain in full force and effect as to all of the said lands retained by the lessee under the said lease and/or this agreement.

[5] As of July 31st, 2001, gas was no longer produced in paying quantities. Tribute continued to pay McKinley the annual rental payments pursuant to the Unit Operating Agreement, some of which were tendered and accepted late.

[6] The parties entered into a Gas Storage Lease Agreement dated September 24, 1998. Under this lease, which is subject to the (amended) Oil and Gas Lease, Tribute leased certain of McKinley's land for the purpose of constructing and operating a gas storage facility. The term of the Gas Storage Lease was 10 years. Schedule B of this lease provided that "all provisions of the schedule shall be additional and shall be paramount with any of the terms in the original agreement". One term in Schedule B stated as follows:

> This Gas Storage Lease Agreement shall terminate on the tenth anniversary date, if and only if, the lessee or some other person has not applied to the Ontario Energy Board to have the said lands or any part thereof designated as a gas storage area on or before the tenth anniversary date hereof.

[7] No application was made to the Ontario Energy Board ("OEB") before the tenth anniversary of the lease on September 24, 2008. However, in August 2008 Tribute had delivered to McKinley a cheque for the gas storage rental for the period of September 24,

2008 to September 23, 2009. Though the cheque was dated September 19, McKinley was able to deposit it to its account on August 25, 2008.

[8] In October 2008, Tribute asked McKinley to enter into a Gas Storage Lease Amendment which would allow Tribute an additional year, until September 24, 2009, to make an application to the OEB to designate the lands as a gas storage area. McKinley sought legal advice. Eventually, McKinley, by a letter from its lawyer dated December 9, 2008, declined to execute the Gas Storage Lease Amendment, took the position that the Gas Storage Lease had terminated on September 24, 2008, returned the rental payment for the ensuing year, and invited an offer "for a fair market value lump-sum payment to reflect the value of acquiring control of the reservoir". It also took the position that the Oil and Gas Lease had terminated in 2001 when oil or gas were no longer produced in paying quantities.

[9] Tribute applied to the court pursuant to rule 14.05 of the *Rules of Civil Procedure*, R.R.O. 1990, Reg. 194, seeking declarations that the two leases each remained valid and McKinley applied for declarations that each of the leases had terminated.

B. THE APPLICATIONS JUDGE'S DECISION

[10] The applications judge first considered the Oil and Gas Lease by itself. The Oil and Gas Lease's term of 10 years would be extended so long as oil and gas were being produced in paying quantities. He found that when production in paying quantities ceased in 2001 and the "well ran dry", the Oil and Gas Lease terminated.

[11] The applications judge then considered whether this result was affected by s. 3(b) of the Unit Operating Agreement, which I have quoted above. He observed first that s. 3 dealt with "payments" under the original lease, and did not purport to amend the term of the lease. He described it as "camouflaged under a section one would expect dealt solely with compensation". Second, he observed, that s. 3 (b) refers only to "deemed production" and not "deemed production 'in paying quantities'". As both the Oil and Gas Lease and the Unit Operating Agreement had been drafted by Tribute or its predecessor, the *contra proferentum* principle applied. Therefore, the applications judge concluded that "the failure to incorporate the necessary wording 'in paying quantities' is fatal" and that "[e]xact wording would have to be used in order to make that deemed production clause effective."

[12] The applications judge added that there was no reason to expect that a party signing such an amending agreement "would anticipate finding, buried in a sub-clause dealing with payment, the potential change of the duration and term of the lease."

[13] The applications judge declared that therefore the Oil and Gas Lease had terminated in 2001.

[14] The applications judge's analysis of the Gas Storage Lease was straightforward. The clause in Schedule B was clear -- it provided that the lease would terminate automatically on the tenth anniversary date if no application was made to the OEB. That clause was paramount to the renewal clauses in the Gas Storage Lease itself.

[15] The applications judge reasoned that it did not matter whether either party knew about the term in the lease or what actions they took subsequent to the lease. The automatic termination clause did not require Tribute to make an application to the OEB. Therefore its failure to do so could not be regarded as a default from which relief against forfeiture could be claimed. The reason that no application was made within the 10 year time limit did not matter. No application was made and the lease came to an end. The applications judge concluded that no contractual or equitable remedy was available to revive the Gas Storage Lease.

[16] Therefore the applications judge granted a declaration that the Gas Storage Lease terminated on September 24, 2008.

[17] Having found in McKinley's favour that both leases were terminated, the applications judge ordered Tribute to pay McKinley costs in the amount of $81,125.37 all inclusive.

C. ANALYSIS

[18] The parties are agreed that the recent decision of this court in *Snopko et al. v. Union Gas Ltd.*, 2010 ONCA 248, does not apply to this case. In *Snopko*, this court examined the scope of the privative clause set out in s. 38(3) of the *Ontario Energy Board Act*, 1998, S.O. 1998, c. 15, Sched. B (the "Act"), which states as follows:

> No action or other proceeding lies in respect of compensation payable under this section and, failing agreement, the amount shall be determined by the Board.

[19] Section 38(1) provides that the OEB may make a designation order authorizing a person to "inject gas into, store gas in and remove gas from a designated gas storage area, and to enter into and upon the land in the area and use the land for that purpose" and such an authorized person is required under s. 38(2) to make "just and equitable compensation" for the right to store gas or for any damage resulting from the authority to do so. The substances of the claims in this case do not fall within the language of s. 38(2) as no designation order has been made by the OEB in relation to these lands. The court's jurisdiction to determine the questions on appeal is not at issue.

[20] Turning to those questions, I begin with the Gas Storage Lease. I agree with the analysis of the applications judge that the automatic termination clause of Schedule B is a true condition precedent. It provides that the Gas Storage Lease will terminate on the tenth anniversary date "if and only if" Tribute or "some other person" has not made an application to the OEB. The words of the clause and the contract read as a whole do not indicate that the automatic termination provision was for the benefit of one party or the other. Rather, the parties chose a particular event, the non-occurrence of which would terminate the contract. The clause does not place any obligation of performance on Tribute that McKinley could waive. The applications judge was correct to find that the initial acceptance of the rental payment for the ensuing year could not constitute a waiver or estoppel by conduct on the part of McKinley.

[21] The applications judge was correct to grant the declaration that the Gas Storage Lease terminated on September 24, 2008.

[22] I do not, however, agree with the result reached by the applications judge in regard to the Oil and Gas Lease. The Oil and Gas Lease and the Unit Operating Agreement are composed entirely of fine print. While Tribute is an oil and gas company and McKinley operates a farm, these are commercial documents that create a sophisticated and long-term commercial arrangement. I see no issue of a "camouflaged" clause or of language being "buried in a sub-clause". McKinley must be taken to have assented to the contents of the documents that it, or its predecessor, executed. All that is necessary is to construe the language of the contract.

[23] The language of the contract does not support the distinction the applications judge made between "deemed production" and "deemed production in paying quantities". I repeat the language of para. 3 of the Unit Operating Agreement for convenience:

> And as long as the payments in this clause provided are made or tendered, operations for the production of the leased substances from the unit area shall be deemed to be conducted by the lessee on the said lands under the said lease, and the said lease as hereby amended shall remain in full force and effect as to all of the said lands retained by the lessee under the said lease and/or this agreement.

[24] What is deemed are "operations for the production of the leased substances from the unit area". These operations are deemed "to be conducted by the lessee on the said lands under the said lease". The words "under the said lease" imply production in paying quantities because that is what the lease is about. The more important point is that the clause provides that "deemed production" keeps the lease in full force and effect. Moreover, I cannot agree that the location of the clause in the Unit Operating Agreement

can be taken to mean it applies to compensation only and not to the term of the lease. The words that the lease as amended shall "remain in full force and effect" could not be a clearer reference to the duration and term of the lease.

[25] I would conclude that the "deemed production clause" extended the lease as long as the annual rental payments continued to be made. The rental payments were made, though some were late.

[26] The applications judge did not find it necessary to deal with McKinley's alternative submission that the Oil and Gas Lease terminated automatically when Tribute failed to make the annual rental payments by January 20 of every year. As noted above, McKinley accepted the payments in the years in which they were made late. I would not give effect to McKinley's submission.

[27] The Oil and Gas Lease, as I read it, does not stipulate that failure to make the rental payments on time should operate to automatically terminate the contract. Such a construction is inconsistent with the provision of the Oil and Gas Lease that provides:

> In the event of default on the part of the Operator in making any payments hereunder or in complying with any of the conditions herein contained, the Land Owner shall notify the Operator by registered mail of his intention to cancel this lease. The Operator shall have 30 days from the receipt of such notice in which to remedy such default failing which the Land Owner may proceed to cancel this lease according to law.

[28] McKinley never gave Tribute notice of default and intention to cancel the lease but accepted the late payments.

[29] I would conclude that the applications judge erred by declaring that the Oil and Gas Lease terminated when the production of gas in paying quantities ceased in 2001. Operations for such production were deemed to continue by Tribute making annual rental payments, and the lease remained in full force and effect.

D. CONCLUSION

[30] I would allow the appeal in part by setting aside the applications judge's declaration that the Oil and Gas Lease terminated. I would grant a declaration that it is a valid and subsisting lease. I would dismiss the appeal in regard to the applications judge's declaration that the Gas Storage Lease terminated.

[31] I would fix the appellant's costs of the appeal in the amount of $15,000 including disbursements and GST. As success before the applications judge should have been divided, I would set aside the applications judge's disposition of costs and replace it with an order of no costs.

"R.G. Juriansz J.A."
"I agree R.P. Armstrong J.A."
"I agree S.E. Lang J.A."

RELEASED: June 02, 2010