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Ontario Court of Appeal holds that oil and gas lease continued by virtue of (late) payments under a unitization agreement

By Nigel Bankes

Cases Considered:

Tribute Resources v McKinley Farms, 2010 ONCA 392

The Court of Appeal has varied in part the decision in *Tribute Resources v McKinley Farms* that I blogged here. The trial judge held that any rights that Tribute held under the terms of an oil and gas lease or under the terms of a gas storage agreement (GSA) had terminated.

The Court of Appeal agreed with the trial judge on the GSA point but held that trial judge had erred in holding that the lease was continued by the terms of the unitization agreement. The Court of Appeal concluded that this was an ordinary commercial contract and that the Court must give effect to its terms. The agreement provided that payments under the unitization agreement were effective to deem production on the leased lands. The fact that some payments were late was not significant since the lease did not provide for automatic termination; the default clause was evidence of that and the default clause seemed to allow the lessee the right to notice and the opportunity to cure a default. There had been no notice of default and ergo the deeming was effective.

Analysis

This was certainly an odd unitization agreement. While a unitization agreement will always amend the underlying leases it usually only does so to the extent that production or deemed production or operations somewhere on the unitized lands will continue the underlying leases. If there is no production then the entire arrangement will come to an end. In this case it appears that a lessee could continue all the underlying leases merely by means of annual payment even absent any production, deemed production or operations anywhere within the unitized lands.

The trial judge clearly thought that this was unreasonable conclusion and therefore strove to interpret the relevant clause of the unit agreement more restrictively. Thus, for him, the unit agreement modified the payment clause of the lease but not the duration clause (the habendum). The Court of Appeal rejected this on the grounds that this was a commercial agreement and that the language was clear (at para. 22): "I see no issue of a 'camouflaged' clause or of language being 'buried in a sub-clause'".

But Tribute faced another hurdle. Tribute had to show that its late payments were not fatal to the deeming which it needed to keep the lease alive. The Court held that late tendering was not fatal since the lease did not provide for automatic termination: evidence, the default clause.

It is hard to reach a final assessment of the merits of this conclusion in the absence of the actual language of the lease but I can say that the Court's reasoning is unpersuasive, or at least that it would be in Alberta given a series of decisions of the Court of Appeal which tell us that a default clause only helps a lessee that breaches an *obligation*. If deeming by payment is an *option* then the lessee is not in default and has nothing to cure; the lessee never gets the benefit of deeming and the lease expires in accordance with its terms: *Freyberg v Fletcher Challenge Oil and Gas Inc*., 2005 ABCA 46.