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Two Manitoba Oil and Gas Lease Termination Cases

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Cases Commented On: *Corex Resources Ltd. et al. v 2928419 Manitoba Ltd.*, 2020 MBQB 47 (CanLII) and *6660894 Canada Ltd. v 57110 Manitoba Ltd.*, 2020 MBQB 50 (CanLII)

Two Manitoba oil and gas lease termination cases; two days apart – March 10, 2020 and March 12, 2020; same judicial district (Brandon); same outcome (leases terminated); but different judges and significantly different analytical and doctrinal approaches. The *Corex* decision is grounded in the specialized body of case law which recognizes that oil and gas leases can terminate automatically in accordance with their terms. The *6660* decision takes a contractual approach and frames the case in terms of fundamental breach and repudiation. While both decisions get to the same point (the lease in each case had terminated), the reasoning in *Corex* is far more consistent with the relevant authorities.

Corex

2928419 Manitoba Ltd (292) was the assignee of a petroleum and natural gas lease to the E ½ originally granted to BA Oil in 1950. The lease had a ten year primary term. The current owners of the E ½ (Computershare and Selby) top leased the minerals to the assignor of Corex in 2018 and 2019. In this action, the applicants (Corex as the top lessee and the lessors, collectively "lessor interests"), sought a declaration that 292's lease had terminated and an order discharging the caveat protecting the 292 lease. In addition, the applicants sought an order requiring 292 to disgorge any profits earned by 292 from production after the date the lease had terminated.

The BA Oil lease could be continued beyond the end of its primary term by production. The third proviso to the habendum also provided, so far as relevant, that the lease could be continued by drilling or working operations (provided no cessation of more than 30 days), and further, that other delays or interruptions would not be counted against the lessee, provided that such delay or interruption was the result of a cause beyond "the Lessor's [*sic*, presumably lessee's] control". 292 admitted that there had been no production of leased substances between: (a) November 2016 to October 2018; (b) January 2019; and (c) May 2019 to December 2019.

Justice Menzies concluded as follows. First, absent production, the onus was on 292 to demonstrate that the lease did not terminate for one of the reasons referenced in the third proviso: *Freyberg v Fletcher Challenge Oil and Gas Inc.*, 2005 ABCA 46 and C*anada-Cities Service Petroleum Corporation v Kininmonth*, 1963 CanLII 525 (AB CA).

Second, "working operations" requires "meaningful activities directed to bringing about production of the leased substances": *Stewart Estate v TAQA North Ltd*, 2015 ABCA 357, *P.*

Burns Resources Limited v Locke, Stock & Barrel Company Ltd., 2014 ABCA 40 and *Montreal Trust Co. v Williston Wildcatters Corp.*, 2002 SKCA 91. Although 292 did some work on the site related to cleaning up oil spills and to deal with significant electrical issues, this did not meet the test: "The work of remediating the site after each spill was part and parcel of maintaining the site and not directed at the production of oil." (at para 28) Furthermore, it was not clear why the work took as long as it did or why, when the work was completed in August 2018, production did not recommence until November 2018.

Third, 292 could not establish a cause beyond the lessee's control: "Oil spills due to operator error are within the control of the lessor [*sic*, lessee]" (at para 33) and "The necessary upgrades to the electrical system are not beyond the control of 292. Parties are expected to know the requirements they must meet to operate their sites and to act diligently to comply with those requirements." (at para 34)

Fourth, the lease terminated in accordance with its terms and therefore there was no breach of an obligation of the lessee that would allow the court to relieve against a forfeiture: *East Crest Oil Co. Ltd. v Strohschein and Strohschein*, 1952 CanLII 209 (AB CA) and *Langlois v Canadian Superior Oil of California Limited*, 1957 CanLII 441 (MBCA).

Fifth, the lessor interests were not estopped from taking the position that the lease had terminated – either on the basis that estoppel cannot revive a dead lease, or on the basis that 292 never relied on any representation of the lessor but relied instead on its own understanding that the lease was valid, or on the basis that the lessor interests were not aware of the reasons for non-production: *Canadian Superior Oil v Hambly*, 1970 CanLII 3 (SCC), [1970] SCR 932.

Finally, 292 should be required to disgorge net revenues earned since the lease terminated (October 2018): *Stewart Estate v TAQA North Ltd*, 2015 ABCA 357. There was no basis for applying the harsh version of the disgorgement remedy (i.e. gross revenues) since there was no evidence (at para 49) of "malicious, oppressive and high-handed conduct deserving the full condemnation of the court." Given that 292 had not provided evidence of its costs to set off against gross revenues, the Court exercised its discretion to give leave to 292 to produce evidence of its production costs. Should 292 fail to do so, the lessor interests would have judgment for the full amount of gross revenues received. (at para 50) For further discussion of the harsh and mild rules for disgorgement see Nigel Bankes, "Termination of an Oil and Gas Lease, Covenants as to Title, and Assessment of Damages for Wrongful Severance of Natural Resources: A Comment on *Williston Wildcatters*" (2005), 68 Sask L Rev 23.

In line with all of this, Justice Menzies granted the declaration that the lease had terminated, ordered discharge of the caveat, and ordered disgorgement on the terms indicated in the last paragraph.

All of this is consistent with the case law on the oil and gas lease, much of it cited in the judgment. It is nice to see the judgment moving quickly to adopt the mild disgorgement rule without flirting with what I have termed "the extra-mild rule" (i.e. compensation to the lessor based on a royalty under a fictitious lease, a nonsense I have criticized elsewhere, see above case comment on *Williston Wildcatters* and my post on *Stewart Estate* here).

6660

This decision involves the rights of two numbered companies. 57110 Manitoba Ltd (5711) owned the oil and gas rights in the NW ¼ and 6660894 Canada Ltd (6660) held the working interest in the same lands pursuant to three leases (two of the leases date from1994, while the third dates from 2011), each of which was protected by a caveat. The judgment does not explain why there are three leases, but there is at least one material difference in the provisions of the leases. Specifically, the two 1994 leases both have a suspended well clause that contemplates that where there are no royalties payable, or any operations on the leased lands in any lease year, then, "the Lessee shall release its interest in the lands to the Lessor". By contrast, the 2011 lease (more conventionally) obliged 6660 to make a nominal shut-in payment of $160. In the end however nothing seems to turn on this difference in Justice Abel's reasons for judgment (see para 43).

While Justice Abel's judgment provides the text of the suspended well clauses, the default clause and the force majeure clause of the leases, it does not quote or otherwise reference the habendum provisions. This ultimately makes it difficult to assess Justice Abel's legal approach to the facts of this case.

6660 made all necessary payments (royalties or suspended well payments) under the terms of the leases until August 2014. In response to an application to have the caveats protecting the leases lapsed, 6660 brought this application to have the validity of the leases and the caveats confirmed.

In support of its application, 6660 filed an affidavit averring that 6660 had invested a considerable amount of time, effort and investment valued in excess of $100,000.00 in maintaining and restoring production at the well sites. However, the affidavit was lacking in particulars and Justice Abel accorded it little weight. In particular, the affidavit was inadequate to support 6660's attempts to rely on the force majeure provisions of the leases (at paras 47 – 51).

Justice Abel chose a contractual frame of analysis for his decision. He ruled that the failure of 6660 to, either obtain production from the leased lands, or make a suspended well payment, constituted a fundamental breach of the contract insofar as (at para 40) "5711 has been deprived of substantially the whole benefit under the Leases which it was the intention of the parties that 5711 should obtain." Justice Abel went on to conclude that 6660 had repudiated the leases and that (at para 42) "5711 is entitled to accept the repudiation and treat the Leases as at an end." There is no discussion as to how 5711 unequivocally accepted that repudiation.

Given his contractual analysis, Justice Abel had to deal with the default clause which contemplated that the lessor could only terminate the lease following notice and an opportunity for the lessee to remedy any default. The default clause also contained the usual proviso stipulating that the lessor would be confined to a remedy in damages should there be a well on the lands capable of production. While the lessor had not served a formal default notice on 6660, Justice Abel pronounced himself satisfied (at para 56) "that either by the delivery of the Notices to Lapse the Caveats, or the affidavit of Cynthia Ostapyk, filed and served on behalf of 5711, 5711 has provided the necessary notices." This particular conclusion would seem to be inconsistent with general landlord and tenant case law on the particulars of default notices.

Justice Abel dealt with the argument on the proviso by concluding that 6660 had failed to meet its onus (at para 60) "to show that there is a well capable of producing, or that operations are being conducted on the wells sites covered by the Caveats." He went on to conclude that even if there were such a well, 6660 would not be able to rely on the proviso because of its fundamental breach:

> To limit the remedy of 5711 to damages only, despite that fundamental breach - a breach of a primary obligation of 6660 - results in 5711 having to continue to sue 6660 for damages, and still not be able to access and profit from the Oil, which it owns. Given that there is a fundamental breach, the contract being repudiated by 6660, 5711 is not limited to only seeking a judgment for damages. Rather, 5711 can have the Caveats lapse, as it has requested. (at para 63)

Arguments as to estoppel also failed as did 6660's request for relief from forfeiture.

In sum, Justice Abel dismissed 6660's application and lapsed the caveats.

As noted above, we do not have the habendum text for any of these leases. But *if* the habendum took the conventional form of a primary term and continuation thereafter for so long as the leased substances are produced, or during the time for which any relevant shut in royalty or suspended well payment is made, then, on the facts given, the leases would all have terminated automatically on their own terms without the need for notice – much as in *Corex*. In other words, there was likely a much easier route for deciding this case than the route actually adopted by Justice Abel. Such an easier and preferred route would have allowed Justice Abel to avoid skating on the thin ice of those passages of the judgment dealing with repudiation and the suggestion that the lessor had complied with the notice provisions of the default clause.

This post may be cited as: Nigel Bankes, "Two Manitoba Oil and Gas Lease Termination Cases" (April 14, 2020), online: ABlawg, http://ablawg.ca/wp-content/uploads/2020/04/Blog_NB_CorexvNB.pdf