1960

*Jan. 27, 28
Apr. 11

SHELL OIL COMPANY (*Plaintiff*).....APPELLANT;

AND

EINAR MAYNARD GUNDERSON (*Defendant*).....RESPONDENT.

ON APPEAL FROM THE SUPREME COURT OF ALBERTA, APPELLATE DIVISION

Real property—Mines and minerals—Whether lease for petroleum and gas expired at end of five-year period—Pooling provision.

In July 1950, the plaintiff was granted a petroleum and gas lease in respect of the south-east quarter of a section for five years "and so long thereafter as the leased substances or any of them are produced from the said lands". It was provided that if after the five-year period the leased substances were not being produced and the lessee was then engaged in drilling or working operations thereon, the lease would remain in force so long as such operations continued or if any materials were produced so long as the materials were produced. The lessee had the right to pool or combine the lands or any portion thereof with adjoining lands to form a unit, and drilling operations on or production from any lands included in such unit would have the affect of continuing the lease. Clause 3 required the lessee to pay a yearly royalty for all wells on the said lands where gas only or primarily was found and not used or sold, and while the royalty was paid, such wells were to be deemed producing wells. The lease defined the term "said lands" as meaning "all the lands hereinbefore described or referred to". The plaintiff did

*PRESENT: Kerwin C.J. and Locke, Abbott, Martland and Ritchie JJ.

not drill any wells on the quarter section or produce any of the substances, but in 1952 drilled a gas well on the north-east quarter of the same section. This well was capped and not connected to any gathering system. Shortly before the expiry of the five year period, the plaintiff gave a notice pooling the south-east quarter with other land, including the quarter on which the gas well had been drilled and capped, and tendered the yearly royalty. The plaintiff's action for a declaration that the lease was in full force and effect was dismissed by the trial judge. This judgment was affirmed by the Court of Appeal.

Held: The lease no longer subsisted.

The five-year term had expired and there was no well on the quarter-section and no production from the well on the north-east quarter. The pooling provision, in itself, did not result in any extension of the primary five-year term. To be effective to continue the lease in force, drilling operations had to be of the kind defined in the lease, and none of that kind had been made. The capped well was not a producing well under clause 3 so as to continue the term of the lease beyond the five-year period. *Prima facie,* clause 3 could only apply in relation to a gas well on the quarter section and there was no such well. The pooling provision did not provide that the existence of a non-producing gas well on some part of the unit, other than the quarter section, would have the same effect in extending the term as though it were upon the quarter section itself.

APPEAL from a judgment of the Supreme Court of Alberta, Appellate Division[1], affirming a judgment of Primrose J. Appeal dismissed.

R. A. MacKimmie, Q.C., and *J. H. Laycraft,* for the plaintiff, appellant.

J. M. Robertson, Q.C., for the defendant, respondent.

The judgment of the Court was delivered by

MARTLAND J.:—The issue in this case is as to whether a petroleum and natural gas lease, dated July 19, 1950, granted by Herbert Frank Morris to the appellant in respect of the south-east quarter of section 13, township 21, range 29, west of the 4th meridian, in the Province of Alberta (hereinafter referred to as "the quarter section"), is still in force and effect, as contended by the appellant, or whether it expired at the end of its primary term of five years, as contended by the respondent. The respondent is the executor of the last will and testament of Herbert Frank Morris, the lessor, who is now deceased. The learned

[1][1959], 28 W.W.R. 506.

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trial judge and the Appellate Division of the Supreme Court of Alberta[1], by unanimous judgment, have decided in favour of the respondent.

The lease stated that the lessor, being registered as owner of the quarter section, in consideration of the payment to him of $2,500 by the appellant and in consideration of the royalties in the lease reserved:

> DOTH HEREBY GRANT AND LEASE unto the Lessee all the petroleum and natural gas and related hydrocarbons except coal and valuable stone, (hereinafter referred to as the "leased substances"), within, upon or under the lands hereinbefore described . . .
>
> TO HAVE AND ENJOY the same for the term of Five (5) years from the date hereof and so long thereafter as the leased substances or any of them are produced from the said lands, subject to the sooner termination of the said term as hereinafter provided.

This was followed by a proviso, not applicable in the circumstances of this case, and then by a further proviso which reads, in part, as follows:

> AND FURTHER ALWAYS PROVIDED that if at any time after the expiration of the said Five (5) year term the leased substances are not being produced on the said lands and the Lessee is then engaged in drilling or working operations thereon, this Lease shall remain in force so long as such operations are prosecuted and, if they result in the production of the leased substances or any of them, so long thereafter as the leased substances or any of them are produced from the said lands; . . .

The other clauses of the lease material to this appeal are the following:

> 1. In this Lease, unless there is something in the subject or context inconsistent therewith, the expressions following shall have the following meaning, namely:
>
> * * *
>
> (*b*) "Drilling unit" shall mean a section, legal sub-division or other unit of land representing the minimum area in which any well may be drilled on or in the vicinity of the said lands as defined or prescribed by or under any law of the Province of Alberta now or hereafter in effect governing the spacing of petroleum and/or natural gas wells.
>
> (*c*) "Said lands" shall mean all the lands hereinbefore described or referred to, or such portion or portions thereof as shall not have been surrendered.
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> * * *
>
> 3. Provided no royalties are otherwise paid hereunder, the Lessee shall pay to the Lessor each year as royalty the sum of Fifty Dollars ($50.00) for all wells on the said lands where gas only or primarily is found and the same is not used or sold, and while the said royalty is so paid each such well shall be deemed to be a producing well hereunder.
>
> * * *

[1][1959], 28 W.W.R. 506.

9. The Lessee is hereby given the right and power at any time and from time to time to pool or combine the said lands, or any portion thereof, with other lands adjoining the said lands, but so that any one such pool or unit (herein referred to as a "unit") shall not exceed one drilling unit as hereinbefore defined, 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, which are now or may hereafter be in force in relation thereto. In the event of such pooling or combining, the Lessor shall, in lieu of the royalties elsewhere herein specified, receive on production of leased substances from the said unit, only such portion of the royalties stipulated as the area of the said lands placed in the unit bears to the total area of lands in such unit. Drilling operations on, or production of leased substances from, any land included in such unit shall have the same effect in continuing this Lease in force and effect during the term hereby granted, or any extension thereof, as to all the said lands, as if such operation or production were upon or from the said lands, or some portion thereof.

The material facts are not in dispute. No well has ever been drilled by the appellant on the quarter section and since the date of the lease, none of the leased substances has been actually produced from the quarter section. In 1952, the appellant drilled a gas well on the north-east quarter of the same section as that in which the quarter section is situated. This well was capped and is not connected to any gathering system. It is capable of producing natural gas but it has not been on production because of the lack of an outlet for the gas. Under the Drilling and Production Regulations established pursuant to *The Oil and Gas Resources Conservation Act, 1950,* c. 46, Statutes of Alberta, 1950, the spacing unit for a gas well was a section of land.

In June 1955, shortly before the five-year primary term of the lease had expired, the appellant served upon the respondent a notice in the following form:

TO: Honorable Einar Maynard Gunderson, Esq.,
Executor of the Estate of Herbert Morris, Deceased,
4240 Elbow Drive, Calgary, Alberta.

Re: A-554-P & N.G. Lease—Herbert Morris,
SE ¼ Sec. 13, Twp. 21, Rge. 29,
West 4th Meridian
Okotoks Area, Alberta.

Take notice that Shell Oil Company as lessee named in a Petroleum and Natural Gas Lease, dated the 19th day of July, A.D. 1950, granted by Herbert Morris and covering all the petroleum and natural gas and related hydrocarbons except coal and valuable stone. Within, upon or

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under the SE ¼ Sec. 13, Twp. 21, Rge. 29, West 4th Meridian, in the Province of Alberta, hereby pools and combines the said SE ¼ of Sec. 13, Twp. 21, Rge. 29, West 4th Meridian with the NE ¼, the NW ¼ and the SW ¼ of the said Section 13, so as to form a drilling unit as defined in the said lease and as prescribed by regulations of the Government of the Province of Alberta.

DATED at the City of Calgary, in the Province of Alberta, this 22nd day of June, A.D. 1955.

SHELL OIL COMPANY

Original signed by ROBERT N. GADBOIS

Per: _____

Robert N. Gadbois

Manager, Land Department.

"F.J.C."

c.c. Honorable Einar Maynard Gunderson, Esq.,
1016—475 Howe Street, Vancouver 1, B.C.
Area Production
Calgary Division Land
Calgary Division Production.

With this notice was tendered a cheque for $50. Prior to July 19, in each year subsequent to 1955, the appellant tendered to the respondent the sum of $50. None of such tendered payments was accepted by the respondent.

The question in issue is as to whether, as a result of the drilling of the well on the north-east quarter, the service of the notice dated June 22, 1955, to pool into a unit the quarter section and the remaining three quarter sections in the same section, and the tender of the annual payments of $50, the term of the lease was extended beyond the five-year period.

The term is defined as:

> five (5) years from the date hereof and so long thereafter as the leased substances or any of them are produced from the said lands . . .

The five-year term has expired. Admittedly, there is no well on the quarter section, and there has not been production from the well on the north-east quarter.

The appellant, however, relies upon the pooling provision, clause 9, and particularly upon the last sentence of that paragraph, which states:

> Drilling operations on, or production of leased substances from, any land included in such unit shall have the same effect in continuing this Lease in force and effect during the term hereby granted, or any extension thereof, as to all the said lands, as if such operation or production were upon or from the said lands, or some portion thereof.

This provision, in itself, would not appear to result in any extension of the primary five-year term. It provides for drilling operations on or production of leased substances from any land included in the unit having the same effect, in extending the term of the lease, as if they were upon or from the quarter section.

Drilling operations, in order to be effective to continue the lease in force beyond the five-year term, would have to be of the kind defined in the proviso to the habendum clause, which has been previously quoted. That proviso refers to drilling operations "after the expiration of the five-year term". The proviso takes effect only if the lease has been extended as a result of production and if, when production ceases, the lessee is then engaged in drilling operations. The only drilling operations on the unit in this case occurred and were completed in 1952 long before the five-year term expired. They were not drilling operations of the kind contemplated by the proviso.

In so far as the provision of clause 9 relating to production of leased substances is concerned, it does not, in itself, serve to extend the five-year term under the provisions of the habendum clause, previously quoted, because there was no production from any part of the unit at the time when the five-year term expired.

However, the appellant then refers to the provisions of clause 3 of the lease. Its contention is that the capped well, though not located on the quarter section, was on the unit which resulted from the pooling notice, that such capped well by virtue of clause 3 was deemed to be a producing well under the lease and, therefore, leased substances were deemed to be produced from the quarter section after the five-year period expired so as to continue the term of the lease.

The appellant's case must, therefore, depend upon the validity of this interpretation of clause 3 of the lease. That clause relates solely to wells where gas only or primarily is found and the same is not used or sold. The well on the north-east quarter section falls within that category, but the clause restricts this description by referring only to wells "on the said lands". The definition clause, (1)(*c*), provides that unless there is something in the subject or context inconsistent therewith "said lands" "shall mean all the lands hereinbefore described or referred to, or such

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portion or portions thereof as shall not have been surrendered." The only lands "hereinbefore described" were the lands in the quarter section which were described, at the commencement of the lease, by their legal description. *Prima facie,* therefore, clause 3 could only apply in relation to a gas well on the quarter section and there was no such well.

The appellant contends, however, that "said lands" where used in clause 3 refers to the whole section because of the provisions as to pooling contained in clause 9. However, I cannot see anything in the subject or context of clause 3 which is inconsistent with giving to the expression "said lands" its defined meaning in that clause.

Clearly, the appellant did not consider "said lands" in clause 3 to be the whole of the section in the years 1953 and 1954, after the well on the north-east quarter had been drilled, for there appears to have been no tender of any $50 or other payment in those years. The appellant must, therefore, contend that whereas "said lands" in clause 3 meant only the quarter section prior to June 22, 1955, the date of the pooling notice, the meaning changed thereafter, because of the pooling notice, so as to include the whole of the section. I do not agree with this. The subject and context of clause 3 in which the words "said lands" appear remain the same. There is not, in my view, anything contained in clause 9 sufficient to provide that the existence of a non-producing gas well on some part of the unit, other than the quarter section, shall have the same effect in extending the term of the lease as though it were upon the quarter section itself.

I am, therefore, of the opinion that the appellant's contention fails and that the judgments in the courts below correctly decided that the lease in question no longer subsists. I think that this appeal should be dismissed with costs.

Appeal dismissed with costs.

Solicitors for the plaintiff, appellant: Chambers, Might, Saucier, Peacock, Jones, Black & Gain, Calgary.

Solicitors for the defendant, respondent: Fenerty, Fenerty, McGillivray, Robertson, Prowse & Brennan, Calgary.