CALVAN CONSOLIDATED OIL & GAS COMPANY LIMITED (*Plaintiff*) .. APPELLANT;

AND

M. E. MANNING (*Defendant*) ..... RESPONDENT.

1958 *Nov. 7, 10, 11

1959 Jan. 27

ON APPEAL FROM THE SUPREME COURT OF ALBERTA, APPELLATE DIVISION

Contracts—Mines and minerals—Agreement to develop oil areas—Terms of letter to be embodied in formal agreement to follow—Unsettled matters to be arbitrated—Whether enforceable contract—Whether binding contract—The Arbitration Act, R.S.A. 1955, c. 15.

PRESENT: Rand, Locke, Cartwright, Abbott and Judson JJ.

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The defendant made an offer in writing to the plaintiff to exchange a 20 per cent. interest in a petroleum and natural gas development permit he held for a 20 per cent. interest in a similar permit held by the plaintiff. The offer was accepted unconditionally. The letter authorized the plaintiff to dispose of or deal with its permit on behalf of both parties as it saw fit. Should the plaintiff wish to develop the land instead of farming it out or selling it, an operating agreement was to be drawn up the disputed clauses of which could be arbitrated. The contents of the letter were to be reduced to a formal agreement the terms of which were likewise to be settled by arbitration if the parties failed to agree on them. The plaintiff entered into a "farmout agreement" with a third party; the defendant refused to ratify it and refused to sign a formal agreement pursuant to the original agreement.

The plaintiff, in its action, sought a declaratory order that there never had been a contract. The trial judge held that there never was a binding contract. This judgment was reversed by the Court of Appeal.

Held: The appeal should be dismissed. The claim for a declaration that the contract was void for uncertainty failed.

The original agreement made all the necessary provisions to enable the plaintiff to enter into any "farmout agreement" that it might choose. Up to this point, the parties had provided for co-ownership and a complete or partial disposition of the property, and had expressed their intention with precision. The only remaining contingency was the retention, exploration, and development of the property by the parties themselves. In an agreement of this kind, it seemed virtually impossible for the parties at that stage to set out in full what the terms of operation would be if the land were to be developed by one of the parties. There was every reason why the parties here introduced an arbitration clause to deal with this point. The contract was, therefore, not void for uncertainty. The parties knew what they were doing and they expressed their intentions with certainty and a complete lack of ambiguity.

The parties were bound immediately on the execution of the informal agreement, the acceptance was unconditional and all that was necessary to be done by the parties or the arbitrator was to embody the precise terms, and no more, of the letter in a formal agreement. This was a case of an unqualified acceptance with a formal contract to follow. Whether the parties intended to hold themselves bound until the execution of a formal agreement was a question of construction. There was no doubt that such was the case here.

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

C. E. Smith, Q.C., and *W. M. Mackay*, for the plaintiff, appellant.

M. E. Manning, in person.

The judgment of the Court was delivered by

[1] (1958), 25 W.W.R. 641, (1959), 16 D.L.R. (2d) 27.

JUDSON J.:—The contract which is under litigation in this action is concerned with Province of British Columbia petroleum and natural gas permits. The respondent, M. E. Manning, was the holder of permit 153 and the appellant, Calvan Consolidated Oil & Gas Company Limited, the holder of permit 120. They entered into negotiations for the exchange of partial interests in these permits and on February 20, 1953, Manning made an offer in writing to exchange a 20 per cent. interest in his permit 153 for a 20 per cent. interest in Calvan's permit 120. On the same day Calvan gave an unconditional acceptance of the offer. Four days later an additional term was agreed to in the same way. The two substantial questions now are, first, whether because of vagueness or uncertainty in the terms, there is an enforceable contract, and second, whether these two documents constitute an immediately binding contract even though there is provision for a formal agreement to follow. Calvan was the plaintiff in the action and sought a declaratory order that there never had been a contract. The learned trial judge granted the order as asked. The Court of Appeal[1], however, held that there was an enforceable contract and dismissed the action. Calvan now appeals to this Court.

I set out in full Manning's letter of February 20, 1953, and the letter of modification dated February 24, 1953:

February 20, 1953.

Calvan Consolidated Oil & Gas Company Limited,
624 Ninth Avenue West,
Calgary, Alberta.
Gentlemen:

This will confirm the arrangement we have made with respect to B.C. Permit 153, which I hold in my name, and Permit 120, which is in the name of Calvan Consolidated Oil & Gas Company Limited.

In principle, I am trading Calvan Consolidated Oil & Gas Company Limited, 20% in return for 20% of Permit 120.

It is agreed that you are to have the right to dispose of, or deal with Permit 120 on behalf of us both in such manner as you see fit. If the Permit is sold, then you will account to me and my partners for 20% of the proceeds of the sale. If the Permit is not sold, then the 20% interest is a working interest, which will be reduced proportionately as Calvan's interest is reduced, should a farmout be negotiated.

If Calvan desires to develop this land instead of farming it out, or otherwise disposing of it to a third party, then development by Calvan is to be subject to an operating agreement, which will be drawn up.

[1] (1958), 25 W.W.R. 641, (1959), 16 D.L.R. (2d) 27.

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The terms of the operating agreement will be mutually agreed upon; and if agreement cannot be reached on any particular clause, then the clause in question will be arbitrated by a single arbitrator, pursuant to The Arbitration Act of Alberta.

You are to have a 20% beneficial interest in Permit 153, the understanding being that a syndicate agreement will be prepared providing for a majority vote on all future action.

Each of us agrees to keep his Permit in force until the end of the third year. It is also agreed that a formal agreement will be drawn up as soon as possible.

Yours very truly,
"M. E. Manning"
M. E. Manning

ACCEPTED by Calvan Consolidated
Oil & Gas Company Limited.

"F. L. Fournier"
F. L. Fournier, Vice-President.

24th February, 1953.

The following is agreed to as an addition to the agreement dated 20th February, 1953 between Calvan Consolidated Oil & Gas Company, Limited and M. E. Manning, re B. C. Permits 153 and 120.

"IT IS AGREED THAT the terms of the formal agreement are to be subject to our mutual agreement, and if we are unable to agree, the terms of such agreement are to be settled for us by arbitration by a single arbitrator, pursuant to The Arbitration Act of the Province of Alberta."

"M. E. Manning"

CALVAN CONSOLIDATED OIL & GAS CO., LTD.,
per: "Frank L. Fournier"

There are two dealings with these permits that I should mention before proceeding to an examination of the terms of the documents. In the spring of 1953, soon after the negotiation of this agreement, Manning made an agreement with Union Oil Company of California for the development of the land comprised in his permit no. 153. He received the sum of $25,000 from Union Oil Company and properly accounted to Calvan for 20 per cent. of this sum. There was no difficulty of any kind with this agreement either on its terms or the accounting given by Manning. On the other side, in January 1955, Calvan made what has been called a "farmout agreement" with Imperial Oil Limited concerning its permit 120. It is unnecessary to deal in detail with the discussions that took place between Manning and Calvan about the Imperial Oil agreement

before it was actually signed. Manning was obviously reluctant to have Calvan enter into this agreement and did not know that it had actually been made until March of 1955. Briefly, his objections were that although under his agreement with Calvan, Calvan had the right to dispose of or deal with permit 120 on behalf of both parties as it might see fit, it could only do so subject to the preservation of his 20 per cent. interest as a "working interest" and the observance of certain obligations arising from the fact that he and Calvan were co-owners of the permit. He complained that the agreement was objectionable on both grounds.

Calvan ultimately asked Manning to sign an elaborate formal agreement pursuant to the clause in the original agreement and at the same time to ratify the Imperial Oil agreement, which was appended as a schedule to the proposed formal agreement. I have no doubt that the proposed formal agreement went far beyond the terms of the original agreement and that Manning was justified in refusing to sign it. He also refused to ratify the Imperial Oil agreement. After much discussion and correspondence between the parties Calvan, in November of 1956, commenced these proceedings.

I now go on to analyse the terms of the impugned agreement and to relate them to the problem of uncertainty. The first provision is for an exchange of interests. If the agreement had stopped at this point, there could be no question of uncertainty and no doubt that legal consequences would follow. It would simply have made provision for the co-ownership of undivided interests in these permits, with nothing said about disposition or operation. There is nothing vague, uncertain or unenforceable about such a legal position.

Next, the agreement provides for three possibilities that may arise in connection with permit 120. These are:

(*a*) an out-and-out sale to a third party;

(*b*) a "farmout agreement" to a third party; and

(*c*) the retention and development of the property by Calvan.

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The out-and-out sale offers no difficulty. Calvan has complete control of the terms, subject to the expressed terms of the contract and its duty to its co-owner, whatever that may be. I am deliberately refraining from expressing any opinion on the nature and extent of Calvan's duty to Manning arising from co-ownership of the permit. The question before this Court is whether or not there is a contract between the two and not one of performance—whether Calvan has fallen short of its duty. If Manning is not satisfied with the conduct of Calvan in making a disposition of this property he will have to litigate that matter in properly constituted proceedings.

The next possible disposition of permit 120 is a "farmout" agreement. The Imperial Oil agreement, to which Manning objected, was in fact such an agreement. Both Manning and Calvan were fully experienced in this line of business and I have no doubt that they knew exactly what they meant by a "farmout" agreement. It involves the transfer of an interest in the property to a third party in consideration of that party doing a certain amount of work at its own expense and possibly making a certain payment in money. The percentage interest which the third party gets in the property must come proportionately from Calvan and Manning. This is covered by the agreement. Again, Calvan has full power of decision in a case of this kind subject only to its duty to preserve Manning's interest as a working interest, to account to him for his proper share of the proceeds of the deal and to observe its duty to him as a co-owner. There is no uncertainty here. There could, of course, have been an endless variation in the type of "farmout" agreement that might have been negotiated by Calvan but this was entirely a matter for Calvan's determination subject to the limitations that I have mentioned. With respect, I am unable to accept the conclusion of the learned trial judge that the parties, when they made their agreement in February of 1953, contemplated that the formal agreement which was to be made later would set out the provisions of any "farmout" agreement that might be made. On the contrary, in my opinion, the original agreement made all the provision that was necessary to enable Calvan to enter into any "farmout" agreement that it might choose.

Up to this point then the parties have provided for co-ownership and a complete or partial disposition of the property. If my analysis is correct, there can be no question of uncertainty on these matters. On the contrary, they have expressed their intention with precision and a commendable economy in the use of words. The only remaining contingency was the retention, exploration and development of the property by the parties themselves. In an agreement of this kind, where the lands may be first of all sold or made subject to a farmout agreement, it seems to me virtually impossible for the parties at that stage of the proceedings to set out in full what the terms of operation would be if Calvan were to develop the land itself. Here are two co-owners who do not know at the point of time when co-ownership is established what they will do with the land. They realize that they may eventually have to develop it themselves. It is a situation that all co-owners may have to face and if nothing more is said between them, they must agree on the terms of the development. If they cannot agree they are at a standstill and must put up with this situation or wind up their association in some way. There is every reason, therefore, why the parties here introduced an arbitration clause into their agreement to deal with this particular point.

The learned trial judge was of the opinion that the provision for arbitration in relation to a possible operating agreement was meaningless and unenforceable. If this were so, the consequence would be that contracting parties in the position of Calvan and Manning who do not know what their ultimate intentions may be if they retain the property must provide in detail for a contingency that may never arise unless they wish to run the risk of having the rest of their contractual efforts invalidated and declared unenforceable. I agree with the opinion of the Court of Appeal that such a situation may be dealt with by an agreement to arbitrate and I can see no legal or practical difficulty in the way. No more could the learned author of Russell on Arbitration, 17th ed., p. 10, when he said:

> Since an arbitrator can be given such powers as the parties wish, he can be authorised to make a new contract between the parties. The parties to a commercial contract often provide that in certain events their contract shall be added to or modified to fit the circumstances then

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existing, intending thereby to create a binding obligation although they are unwilling or unable to determine just what the terms of the new or modified agreement shall be. To a court such a provision is ineffective as being at most a mere "agreement to agree"; but a provision that the new or modified terms shall be settled by an arbitrator can without difficulty be made enforceable.

Even if this were not so, I would accept the view of the Court of Appeal that failure of a term such as this would not invalidate the transfer of property interests and the rest of the agreement, the terms of which had been completely settled.

The remaining two paragraphs of the agreement deal first with the preparation of a syndicate agreement and the obligation of each party to keep his permit in force until the end of the third year. There was no suggestion of difficulty on either of these two points.

My conclusion therefore is that this contract is not void for uncertainty. There is no need here to invoke the principle of a "fair" and "broad" construction of this contract as mentioned by Lord Wright in *Hillas and Co., Limited v. Arcos Limited*[1]. The parties knew what they were doing and they expressed their intentions with certainty and a complete lack of ambiguity.

Only two questions remain to be considered and these arise from the provision in the amending agreement for arbitration on the terms of the formal agreement. The questions are, first, whether this indicates an intention not to be bound until the formal agreement is executed, and, second, what terms may be incorporated in the formal agreement by the arbitrator. My opinion is that the parties were bound immediately on the execution of the informal agreement, that the acceptance was unconditional and that all that was necessary to be done by the parties or possibly by the arbitrator was to embody the precise terms, and no more, of the informal agreement in a formal agreement. This is not a case of acceptance qualified by such expressed conditions as "subject to the preparation and approval of a formal contract", "subject to contract" or "subject to the preparation of a formal contract, its execution by the parties and approval by their solicitors". Here we have an unqualified acceptance with a formal contract to follow.

[1](1932), 147 L.T. 503 at 514.

Whether the parties intend to hold themselves bound until the execution of a formal agreement is a question of construction and I have no doubt in this case. The principle is well stated by Parker J. in *Hatzfeldt-Wildenburg v. Alexander*[1], in these terms:

> It appears to be well settled by the authorities that if the documents or letters relied on as constituting a contract contemplate the execution of a further contract between the parties, it is a question of construction whether the execution of the further contract is a condition or term of the bargain, or whether it is a mere expression of the desire of the parties as to the manner in which the transaction already agreed to will in fact go through. In the former case there is no enforceable contract either because the condition is unfulfilled or because the law does not recognise a contract to enter into a contract. In the latter case there is a binding contract and the reference to the more formal document may be ignored.

Whether or not it is relevant, I am fully satisfied that the parties thought they were bound until very close to the institution of this action. There was substantial performance on both sides, by Manning in making a disposition of permit 153 to Union Oil Company of California and by Calvan in its contract with Imperial Oil concerning permit 120. Neither party felt the necessity of a formal agreement when they were dealing in a very serious way with the subject-matter of their contract and there was no difficulty. The trouble arose when Manning was not satisfied with what had been done.

The appeal should be dismissed with costs. The result is that Calvan's claim for a declaration that this contract is void for uncertainty fails and that is all that is being decided in this litigation. The Court of Appeal quite properly declined to consider Calvan's alternative claim for advice on the propriety of its conduct in entering into the Imperial Oil contract and I would do the same here. If Manning is not satisfied with the provisions of this contract, he must seek his remedy in the usual way with the proper

[1] [1912] 1 Ch. 284 at 288-9, 81 L.J. Ch. 184.

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parties before the Court, and nothing in these reasons should be taken as expressing any opinion or decision on the rights of the parties in such litigation.

Appeal dismissed with costs.

Solicitors for the plaintiff, appellant: Williamson, Mackay & Thomson, Calgary.

Solicitors for the defendant, respondent: Maclean & Dunne, Edmonton.