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Alberta Court follows *Third Eye Capital v Dianor* in a Royalty Characterization Case

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Case Commented On: *Manitok Energy Inc (Re)*, 2018 ABQB 488 (CanLII)

In a welcome development Justice Karen Horner has followed the Ontario Court of Appeal's recent decision in *Third Eye Capital Corporation v Resources Dianor Inc.*, 2018 ONCA 253 (CanLII) (the subject of a post here) and concluded that the royalty agreements at issue in this case were intended to create an interest in land and did in law create such an interest notwithstanding that the royalty was described as in interest in oil volumes once produced rather than as in interest in the minerals themselves.

Freehold Royalties Partnership claimed a royalty interest, "the Producing Royalty", in certain lands in which Manitok had producing interests (acknowledged to be a *profit à prendre* (at para 25)) pursuant to a Production Volume Acquisition Agreement and a Production Volume Royalty Agreement (Royalty Agreement). In consideration, Freehold provided Manitok $25 million in cash. A third agreement, the Clarification Agreement, between Manitok, Freehold and National Bank of Canada (NBC), confirmed that the NBC had no security interest in the Producing Royalty. Freehold took its royalty in money until August 2017 when it elected to take in kind and continued to do so until the date of Manitok's bankruptcy and the appointment of a receiver, February 20, 2018. The receiver took the position that the Producing Royalty was not an interest in land.

There was, as Justice Horner noted (at para 5) and in light of the terms of the agreement, little doubt but that it was the intention of the parties that the Producing Royalty was to be an interest in land. For example, "Producing Royalty" was defined in the Royalty Agreement (at para 6) as "the non-convertible production volume royalty, *being an interest in land*, granted by the Grantor to the Grantee in accordance with Clause 2.1 of this Agreement and as set out and described in Schedule "B" of this Agreement" (emphasis added) and Schedule B provided as follows (at para 7):

> Grant: In accordance with Section 2.1 and this Schedule "B", the Producing Royalty is granted by Grantor to Grantee in respect of all Oil Volumes within, upon or under the Royalty Lands. *It is the express intention of the Parties that the Producing Royalty therein granted by Grantor to Grantee constitutes, and is to be construed as, an interest in land and runs with the Royalty Lands and the Parties intend that the Producing Royalty shall be an interest in land...*
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> Amendment: The Producing Royalty shall continue for so long as all or any portion of the Royalty Lands remain subject to the Documents of Title existing on the date hereof, as may be amended, renewed, extended or replaced, provided that if any Documents of Title expire or terminate, the Producing Royalty shall no

> longer apply to those of the Royalty Lands previously the subject of such expired or terminated Document of Title...
>
> No Objection: Grantee on behalf of itself and its Affiliates, acknowledges and agrees that it is forever estopped from taking any action whatsoever to dispute, challenge, contest or contend in any manner whatsoever that the Producing Royalty is an interest in land in the Royalty Lands.
>
> Calculation of Producing Royalty: Grantee shall receive, on a first-priority basis, the Producing Royalty on production of Oil Volumes from the Royalty Lands... (emphasis added),

The two agreements between Freehold and Manitok certainly had some unusual provisions which are mentioned by Justice Horner (at paras 10 - 12) including the following:

> The Producing Royalty is never expressed as a percentage or share of petroleum substances, but instead it is expressed as the first 140 barrels per day produced from the Royalty Lands. The Producing Royalty is subject to an Initial Term of 8 years, followed by a wind-down period during which the volumes of the Producing Royalty decrease by 10% per year, relative to the prior year, even if production from the Royalty Lands remains steady or increases. Moreover, the Producing Royalty may originate in oil volumes produced from other areas operated by Manitok: as long as the daily production from the Stolberg Royalty Lands remains at least 140 barrels, there may never be a Producing Royalty from either the Wayne or the Carseland Royalty Lands.
>
> Article 9 of the Royalty Agreement, entitled "Assignments and Dispositions" provides that Manitok is allowed to assign its entire interest in the Royalty Agreement without Freehold's consent, but only upon substantial notice to Freehold, and only if Manitok includes in such notice a substitute property which would provide Freehold with a comparable Producing Royalty.
>
> Article 4 of the Royalty Agreement provides that Freehold is authorized to enter the Royalty Lands to remedy any default in Manitok's compliance with the Committed Capital Program, and would then entitle itself to Manitok's "working interest share of production of Oil Volumes from the Royalty Lands until the proceeds from the sale of that production equals three hundred percent (300%) of all amounts expended by Freehold in the conduct of such operations.

Nevertheless, Justice Horner was convinced by the reasoning in *Dianor* that none of this was sufficient to undermine either the stated intentions of the parties or to reach beyond what might qualify as a royalty as a matter of law. In particular, she rejected the proposition (at para 25) that "the Producing Royalty is not carved out of an interest in land because it is granted in crude oil and condensate that have already been produced, and are therefore severed from the land."

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