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Manitoba decision on the assignment of a royalty interest

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Case Commented on:

Campion et al v Radomski et al, 2012 MCQB 267

In this case the beneficiaries of the Milliken estate (the beneficiaries) sought to ignore an assignment of a royalty interest that Milliken had executed during his life in favour of the Manning interests. The parties entitled to the Manning royalty interest sued to enforce that assignment and in this case the court dismissed an application by the beneficiaries (the defendants) for summary judgement.

The facts

Milliken, as the registered owner of the mines and minerals estate, entered into a petroleum and natural gas lease with California Standard (CS) in 1950. One of the provisions of the lease (cl. 24) provided that the Lessor could only assign its entire interest in the lease and that CS was not required to recognize a partial assignment. In 1951 Milliken entered into an "Assignment Part of Royalty (Petroleum)" agreement with the Manning Group which provided in part as follows:

> 1. … the Assignor doeth hereby assign, transfer, convey, grant and set over unto the Assignee, his heirs, administrators, executors and assigns, an undivided six and one quarter per cent of all the productions of the leased substances or any of them, produced, saved and marketed from the said lands hereinbefore described, calculated and payable as set out and provided for in the said lease agreement make between the Assignor herein as Lessor and the California Standard Company as Lessee and dated the 21st day of September A. D. 1950, as aforesaid.
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> 3. The Assignor covenants and agrees with the Assignee that this assignment shall not only cover and include the percentage of the production of the leased substances herein assigned and set over unto the Assignee but shall also cover, include and apply to all productions of the leased substances or any of them produced, saved and marketed from the said lands under and by virtue of all leases to be entered into between the Assignor and any other person … in the future.
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> 4. In the event the said lease agreement hereinbefore mentioned is cancelled, terminated, surrendered or lapses or is determined for any cause whatsoever, the Assignor shall forthwith use his best endeavours to enter into a new lease covering the leased substances: the terms, conditions and stipulations of the new lease to be first agreed upon between the parties hereto, two of the terms of which

> lease agreement shall be that the royalty payable to the Assignor under the said lease shall be divided as to fifty per cent to the Assignor and fifty per cent to the Assignee, and that the new Lessee shall at all times observe the terms and conditions and stipulations of this agreement and if the Lessee fails to perform, drill for, win or get the leased substances from the said lands according to the terms, conditions and stipulations of the new lease so that the same is cancelled by either party, or lapses or is terminated, the Assignor shall enter into a new lease agreement with a new person, partnership or corporation according to the terms, conditions and stipulations hereinbefore set out and so on until all the leased substances which exist within, upon or under the said lands are obtained and recovered.
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> 6. This Agreement and everything herein contained shall enure to the benefit of and be binding upon the parties hereto, their heirs, executors, administrators and assigns respectively. [Emphasis supplied.]

The Manning Group registered a caveat in relation to its interest. CS surrendered its lease in 1959 and in 2006 the beneficiaries entered into a petroleum and natural gas lease with Tundra reserving a 15% royalty. Tundra obtained production and has since paid all of the royalty to the beneficiaries. The plaintiffs, the heirs and assigns of the Manning Group, brought this action seeking a declaration that the Tundra lease was unenforceable against them, an accounting in relation to all oil and gas produced from the lands, and an injunction. The beneficiaries in turn brought this application for summary judgement and for an order dismissing the statement of claim. In support of its application, the beneficiaries contended that the Manning agreement did not transfer an interest in land but only provided rights in personam.

The decision

Justice Menzies dismissed the application for summary judgement. The Court reasoned that upon the grant of the CS lease Milliken retained the right of reversion in the minerals and a fee simple interest in the minerals in situ. Examination of the Manning agreement confirmed that Milliken intended to transfer to the Manning Group an interest in the substances in situ. The parties to the agreement intended to share a right in common to participate in the development of the affected minerals for so long as those substances existed in the property. Therefore, this was not a case in which the plaintiffs would stand no reasonable prospect of success. Similarly, clause 24 of the lease could only bind the parties to the lease. The beneficiaries could not rely on clause 24 to avoid obligations that Milliken had assumed in relation to the Manning Group and the clause did not invalidate the assignment to the Manning Group.

Commentary

The decision to dismiss this motion to strike is surely correct, whether on the grounds given or simply on the basis that the beneficiaries of the estate are bound by the contractual undertakings of the testator since they are simply volunteers. The Court is also correct in concluding that a provision in a lease in which the lessee stipulates that it does not have to recognize an assignment of less than the entire interest cannot render void any such an assignment – it can only create rights and obligations as between the parties.

Perhaps then this case will go to trial, or perhaps it is more likely that the parties will settle. Two further points. First, the language of the assignment is unusual. While one of the common forms

of gross royalty trust agreement did provide for an assignment of an undivided interest in the lessor's estate, this particular agreement does not go that far. It does not create the relationship of tenants in common as between the assignor and the assignee in the mineral estate. This is because the assignor does not assign his corporeal estate in the minerals. Instead, Milliken merely assigns an undivided interest in "all the productions of the leased substances or any of them." In the GRTA test cases litigation for example (sub. nom. *Scurry-Rainbow Oil Ltd v Galloway Estate*, [1995] 1 WWR 316) the Fletcher property GRTA provided for an assignment of "the full undivided" 12.5% interest "in and to the said lands" and the Noble property GRTA provided for a grant of "an undivided gross 12 ½% interest in all the substances in, on or under the said lands". Both grants go beyond the scope of the grant in this case. Thus, this may still be an assignment of an interest in land, but it is not quite as obvious as Justice Menzies suggests and it certainly does not create a community of interest in the mineral estate as Justice Menzies hints at.

Second, the relief sought is interesting. The plaintiffs claim, *inter alia*, that the lease is unenforceable against the plaintiff's interest and an accounting of all of the production from the lands. Both elements of this claim seem problematic.

The first claim is problematic since the Manning interests do not have an independent right to lease the lands or any undivided interest in the lands since they are not tenants in common of an undivided interest in the fee estate (see above). Furthermore, even if they were, each tenant in common has the right to lease the minerals and its lessee is entitled to drill and produce (subject to complying with applicable oil and gas conservation rules) subject only to a duty to account for producing somebody else's share i.e. even on that analysis, the Tundra lease would not be unenforceable.

The second claim is problematic because the accounting must surely be limited to Manning's share under the terms of the assignment. True, it seems that the beneficiaries have breached the Manning Agreement by failing to consult on the terms of the Tundra lease, but that only gives rise to an action in damages (and what would be the damages?) It doesn't make the lease void or provide access to an accounting remedy as to the *entirety* of the production.