October 13, 2016

Pre-*Dynex* Royalty Agreements Continue to Spawn Interest in Land Litigation

By: Nigel Bankes

Case Commented On: *Re Walter Energy Canada Holdings, Inc.*, 2016 BCSC 1746 (CanLII)

In 2002 the Supreme Court of Canada handed down its decision in *Bank of Montreal v Dynex Petroleum Ltd*, 2002 SCC 7 (CanLII) in which it confirmed that a gross overriding royalty (GORR) carved out of a working interest in land was capable of subsisting as an interest in land as a matter of law. Whether any particular GORR created an interest in land, or simply a contractual claim, depends upon the intentions of the parties as revealed in the language adopted by the parties to describe the GORR. There is presumably no objection to expressing this intention with words such as "the parties intend that the right and interest created by clause x of this agreement is to be an interest in land" – so long as this intention is not contradicted by other language in the agreement when construed as a whole in accordance with the usual rules on the interpretation of contracts. See, Nigel Bankes, Private Royalty Agreements: A Canadian Viewpoint, Rocky Mountain Mineral Law Institute (2003). While *Dynex* definitively settled the issue of principle (*can* a GORR as a matter of law ever be an interest in land) it still requires an analysis of the intentions of the parties in any particular case, although this should be easier to demonstrate for post-2002 agreements than for pre-2002 agreements. That said, the matter had been widely litigated during the previous 40 years, and counsel should at least have been aware, well before then, of the need to use language appropriate to creating an interest in land rather than a contractual interest – if that was indeed the intention of the parties.

The present case involved a GORR pertaining to certain coal mining licences in British Columbia. The agreement (the GRA) was executed in 2000 by WCC and three geologists, including Mr. James, in return for their assistance in identifying and acquiring the coal properties in question. The Walter Group is the successor in interest to WCC (by way of an acquisition of shares) and, as the petitioners in the case, had filed for protection under the *Companies' Creditors Arrangement Act*, RSC 1985, c C-36 (*CCAA*) (for the background see *Walter Energy Canada Holdings, Inc. (Re)*, 2016 BCSC 107 (CanLII)). In this application, the petitioners were seeking approval of a transaction which would see the sale of the petitioners' mining properties to Conuma Coal Resources. As part of the proposed asset purchase agreement (APA) the parties made it clear that the GRA was "an excluded contract" and that Conuma would not be assuming responsibility for it. Mr. James took the view that this was not an option which was open to the petitioners and Conuma on the basis that the GRA accorded Mr. James and the other parties interested in the GORR an interest in land which ran with the assignment of the coal licences.

The GRA provided in relevant part as follows:

> **WHEREAS:**
>
> A. The Company has made application for and expects to become the beneficial owner of a 100% interest in and to certain coal interests in the West Brazion, Burnt River, Wolverine and Mount Spieker properties… (the "Properties").

B. Each of the Investors [Mr. James et al] have assisted the Company in acquiring and maintaining the Properties;

C. The Company wishes to pay a royalty to the Investors for the Investors' contributions on the terms and conditions herein contained.

THIS AGREEMENT WITNESSES THAT in consideration of the payment by the Purchaser to the vendors of $1.00 and other good and valuable consideration, receipt of which is hereby acknowledged, the parties mutually covenant and agree as follows:

…

2. CONSIDERATION

2.1 As consideration for advancing the funds, the Company will pay a royalty (the Royalty") of one percent (1%) of the price bracket (FOBT at Port) for all product tonnes produced from the West Brazion, Mount Spieker and Wolverine coal properties on a quarterly basis to the Investors as set out in Schedule "2.1"…

3. THE COMPANY'S REPRESENTATIONS AND WARRANTIES

3.1 The Company represents and warrants to and covenants with the Investors as follows:

…

(c) the Company is or will be the beneficial owner of all of the coal licenses comprising the Properties (the "Coal Licenses"), free and clear of all liens, charges and claims of others and no taxes or rentals are or will be due in respect of any thereof;

…

4. COAL LICENSES

4.1 Upon the Coal Licenses being granted and recorded under it in the Company's name, the Company will maintain the Coal Licenses in good standing with the mining recorder, or such other entity with jurisdiction over such matters.

4.2 In the event that any of the Coal Licenses comprising the Properties are not granted or the Company decides to cancel any applications prior to the Coal Licenses being granted, the Investors will be repaid proportionately immediately upon the funds being returned by the government.

4.3 Any forfeiture of the Coal Licenses shall be by mutual consent of the Parties to this Agreement, and such consent shall not be unreasonably withheld. In the event that the Company forfeits the Coal Licenses, the Company will assign the Coal Licenses to the Investors for a minimum period of 30 days prior to the date the forfeiture is to become effective.

…

8. ASSIGNMENT

8.1 This agreement may not be assigned without the written consent of all the parties, which consent shall not be unreasonably withheld.

9. GENERAL

> 9.1 This Agreement will enure to the benefit of and be binding upon the parties and their respective successors, heirs, executives, administrators and permitted assigns.

Justice Fitzpatrick carefully considered the main pre- and post-*Dynex* cases (including *Vandergrift v. Coseka Resources Ltd.*, (1989) 67 Alta LR (2d) 17, 1989 CanLII 3163 (AB QB), *St. Lawrence Petroleum Ltd. v Bailey Selburn Oil & Gas Ltd. and H.W. Bass & Sons, Inc.*, 1963 SCC 76 (CanLII), [1963] SCR 482, *Saskatchewan Minerals v Keyes*, 1971 SCC 183 (CanLII), [1972] SCR 703,*Vanguard Petroleums Ltd. v Vermont Oil & Gas Ltd.*, [1977] 2 WWR 66 (Alta. SC), 1977 CanLII 648 (AB QB), C*anco Oil & Gas Ltd. v Saskatchewan*, [1991] 4 WWR 316, 1991 CanLII 7788 (SK QB), *Scurry-Rainbow Oil Ltd. v Galloway Estate*, [1993] 4 WWR 454, 1993 CanLII 7025 (AB QB); aff'd 1994 ABCA 313 (CanLII), [1995] 1 WWR 316, and *St. Andrew Goldfields Ltd. v Newmont Canada Ltd.*, [2009] OJ No 3266, 2009 CanLII 40549 (ON SC); aff'd 2011 ONCA 377, before concluding that the words used by the parties to this contract did not evidence an intention to create an interest in land but only a contractual interest. Important factors in her decision included the following (at para 67):

> (a) Walter Energy is specifically stated to have "acquired" the licenses and to be the beneficial owner of them free of any "claims of others" (Recital B and clause 3.1(c));
>
> (b) ... Mr. James had no direct rights in respect of the coal licenses and he relinquished any further control in respect of them. Mr. James had no assurance that he would gain any consideration under the royalty if the Properties were never put into production;
>
> c) clause 2.1 does not include any formal conveyancing language to, for example, "grant, assign, transfer or convey" any rights to Mr. James in relation to the coal licenses (*contra Canco*, *Blue Note* and *Scurry-Rainbow*). No such words, or similar words, are used; rather, it is simply an obligation to *pay* the royalty;
>
> d) with Mr. James having some control over WCC at the time, it would have been a simple matter to have included clear language to the effect that Mr. James was to be granted a royalty that would "run with the land" (see *Canco*). As in *Vandergrift*, at p. 27, the choice of language was within his control but no such clear language was used;
>
> e) the reference to the payment of the royalty being based on what is "produced" from the coal properties is simply the means by which the parties agreed to calculate the amount of the royalty. It is not a reference to a royalty *in* the "Properties" or coal licenses: see *St. Lawrence*, *Saskatchewan Minerals*, *Vanguard*, *Vandergrift* and *St. Andrew Goldfields*. I note that the parties disagree as to whether the royalty is due upon production (i.e. once removed from the land), or upon the coal being shipped to port and priced at that time for the purposes of calculating the 1% royalty. In my view, this is not a relevant distinction as, in any event, the coal would have been severed from the lands by that time;

f) clause 4.3 of the RSA indicates that the parties did consider what rights the Investors would have in relation to the coal licenses in the future. Those rights were specifically addressed in the context of a forfeiture of the Properties ... a circumstance which is not relevant here. Further, the RSA does anticipate that any assignment of the RSA by WCC would require the consent of Mr. James (clauses 8.1/9.1). However, that circumstance is not what is happening here, since no one has sought to assign the RSA, let alone without Mr. James' consent; and

g) importantly, the RSA does not restrict the ability of Walter Energy to sell the Properties, and it also contains no obligation on the part of Walter Energy to require any purchaser of the Properties to assume its obligations under the RSA.

While this reasoning trades on all of the artificial and sometimes spurious distinctions which characterized the pre-*Dynex* jurisprudence, and while it is hard to believe why anybody would create a GORR that was not intended to be an interest in land, it is difficult to fault Justice Fitzpatrick's conclusion. This is because *Dynex* still requires assessment of the intentions of the parties as revealed in the language used in the document and any relevant surrounding commercial circumstances, and as such this line jurisprudence, muddled and unsatisfactory as it is, continues to be relevant at this stage of the analysis.

This post may be cited as: Nigel Bankes, "Pre-Dynex Royalty Agreements Continue to Spawn Interest in Land Litigation" (October 13, 2016), on-line: ABlawg, http://ablawg.ca/wp-content/uploads/2016/10/Blog_NB_WalterEnergy_Oct2016.pdf