June 10, 2019

Gross Overriding Royalty Payable on 100% of Production

By: Nigel Bankes

Case Commented On: *Obsidian Energy Partnership v Grizzly Resources Ltd*, 2019 ABQB 406

In this decision, Master J.T. Prowse granted summary judgment in favour of Obsidian (formerly Penn West Petroleum) against Grizzly Resources, concluding that Obsidian's gross overriding royalty interest (GORR) of 2.75% was payable on 100% of production from the encumbered properties rather than on Grizzly's working interest in the properties.

Under the terms of a 2011 agreement (the Undeveloped Acreage Conveyance (UAC)) Obsidian agreed to sell Grizzly its working interest in the section 8 lands in return for a 2.75% royalty payable by Grizzly on both the section 8 lands and the section 5 lands in which Grizzly also held an interest. The UAC in turn referred to a royalty agreement which included in its schedule the 1997 CAPL Overriding Royalty Procedure. Schedule A to the Royalty Agreement indicated (at para 20) that the "royalty calculated on 100%." Grizzly's accounting system was changed contemporaneously to reflect a 2.75% royalty on a 100% of production in relation to both the section 8 and the section 5 lands. In addition, Obsidian's closing summary reflected the same thing, namely: "a 2.75% GORR on the lands conveyed as well as on the N/5-50-6-W5M" (at para 12). For seven years Grizzly paid the GORR on 100% of production but subsequently took the position that this was a mistake and that the GORR was only payable on 56.25% of production. Accordingly, Grizzly commenced withholding payment of any royalty to Obsidian until the 'overpayment' was recovered. That led to the present action.

Master Prowse concluded that there was nothing ambiguous about the agreement between the parties and that the royalty was payable on 100% of production. Grizzly's evidence as to its subjective intention was "likely inadmissible" and in any event of no assistance.

Master Prowse also rejected Grizzly's application to have the action stayed on the basis that the Royalty Procedure favoured arbitration. The relevant provision stipulated that:

> 7(1) If a party to an arbitration agreement commences a proceeding in a court in respect of a matter in dispute to be submitted to arbitration under the agreement, the court shall, on the application of another party to the arbitration agreement, stay the proceeding.
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> (2) The court may refuse to stay the proceeding in only the following cases:
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> (a) a party entered into the arbitration agreement while under a legal incapacity;
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> (b) the arbitration agreement is invalid;

(c) the subject-matter of the dispute is not capable of being the subject of arbitration under Alberta law;

(d) the application to stay the proceeding was brought with undue delay;

(e) the matter in dispute is a proper one for default or summary judgment. (emphasis is that of Master Prowse)

Master Prowse concluded that this was evidently a suitable case for summary judgment and that therefore he should exercise his discretion to decline to stay the action.

While it may not be the norm in the industry for a grantor to commit to pay a GORR on the entire production from a property rather than the grantor's working interest, it is certainly possible for the grantor to make that commitment; and if that is the intention of the parties as revealed in the language of the relevant agreement, then the courts will enforce that commitment. There is at least one other decided case (not cited in the judgment) to the same effect: see *Lyatsky Geoscience Research and Consulting Ltd v Geocan Energy Inc*, 2009 ABPC 392 and for the ABlawg comment, see "Provincial Court Royalty Calculation Decision".

This post may be cited as: Nigel Bankes, "Gross Overriding Royalty Payable on 100% of Production" (June 10, 2019), online: ABlawg, http://ablawg.ca/wp-content/uploads/2019/06/Blog_NB_GrizzlyResources.pdf