

January 11, 2023

The Legal Status of a Gross Overriding Royalty Carved out of a Crown Lease

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Decision commented on: *PrairieSky Royalty Ltd v Yangarra Resources Ltd*, 2023 ABKB 11

This well-reasoned decision of Justice Michel Bourque serves to clarify the legal status of overriding oil and gas royalties in Alberta law. There were two principal matters to resolve: first did the gross overriding royalty (GORR) at issue here amount to an interest in land, and second, if so, was this a legal interest or an equitable interest opposable against the current Crown lessee. Justice Bourque decided both issues in favour of the holder of the GORR, the plaintiff (PrairieSky Royalty Ltd (PRL)), who held the GORR by way of an assignment from the original royalty holder.

The property involved a Crown petroleum and natural gas lease originally granted in 1979. The lease was held by a number of parties in succession over the years but the key point for present purposes is that the GORR was granted by the then lessee (Home Quarter) to Range Royalty in 2011 (at para 11, the HQ GORR or the 2011 GORR). The lessee's interest subsequently became vested in Yangarra, while Range Royalty's interest became vested in PrairieSky.

The terms of the GORR included the following:

2.1 Granting Clause

There is hereby granted to and owned by Grantee an overriding royalty of eight (8%) percent of:

- (a) the quantity, if Grantee elects to take the Overriding Royalty in kind pursuant to the Section of this Article entitled "Taking in Kind"; or
 - (b) the Value, if Grantee has not elected to take the Overriding Royalty in kind pursuant to this Section of this Article entitled "Taking in Kind";
- in the Petroleum Substances within, upon, or under the Royalty Lands to the extent of the Reported Volumes attributable to Grantor's Working Interests in the Royalty Lands...

"Petroleum Substances" are defined as "Crude Oil, Gas and Condensate" as follows:

"Condensate" means a liquid hydrocarbon product that existed in the reservoir in a gaseous phase at original conditions and that is recovered from a gas stream...

"Crude Oil" means crude petroleum oil and any other hydrocarbon, regardless of density, that is or is capable of being produced from a well in liquid form...

"Gas" means natural gas, both before and after it has been subjected to absorption, purification, scrubbing or other treatment or process, and includes all

liquid hydrocarbons other than Crude Oil and Condensate.
“Reported Volumes” are defined as “those production volumes of Petroleum Substances...reported...from each wellhead on the Royalty Lands”.

9.5 Interest in land

The Overriding Royalty constitutes an interest in land, shall be regarded as covenants running with the Royalty Lands, caveatable under the lands registration systems in the provinces where the Royalty Lands are situate and enforceable against Grantor and any successors in interest to Grantor.

9.6 Term

This Agreement shall remain in force and effect so long as Grantor or any successors in interest to Grantor retains a Working Interest in the Royalty Lands. Notwithstanding the foregoing, this Agreement shall terminate with respect to any interest assigned to Grantee pursuant to the Section of this Article entitled “Surrender”.

Issue # 1. Did the Parties to the GORR Agreement Establish the Royalty as an Interest in Land, or was the Arrangement Simply a Contractual Arrangement?

The Supreme Court of Canada clarified the law on the characterization of royalty interests in *Bank of Montreal v Dynex Petroleum Ltd*, [2002 SCC 7 \(CanLII\)](#). The Court endorsed the view that a royalty could be an interest in land if:

- (1) the language used in describing the interest is sufficiently precise to show that the parties intended the royalty to be a grant of an interest in land, rather than a contractual right to a portion of the oil and gas substances recovered from the land; and
 - (2) the interest, out of which the royalty is carved, is itself an interest in land.
- (at para 22, relying on *Vandergrift v Coseka Resources Ltd* (1989), 67 Alta. L.R. (2d) 17, [1989 CanLII 3163 \(ABKB\)](#) at para 29)

Justice Jack Major for the Court also substantially endorsed the reasons of the Court of Appeal for thinking that the royalty in question did constitute an interest in land. For its part the Court of Appeal emphasized that any assessment of the intentions of the parties based on a search for some magic words, such as the reservation of a royalty *in* the lands in question rather than *on* the proceeds of production, was not productive (*Bank of Montreal v Enchant Resources Ltd*, [1999 ABCA 363 \(CanLII\)](#) at paras 68 – 73 (*Dynex ABCA*)).

Nevertheless, perhaps because the Supreme Court itself did not offer much guidance on the question of how to assess the intentions of the parties, lower courts have sometimes struggled with the question of how to apply *Dynex*. The Ontario Court of Appeal offered important guidance in *Third Eye Capital Corporation v Ressources Dianor Inc*, [2018 ONCA 253 \(CanLII\)](#) (which I commented on [here](#)) and Justice Karen Horner subsequently followed that decision in *Alberta Manitok Energy Inc (Re)*, [2018 ABQB 488 \(CanLII\)](#) (commented on [here](#)). But there

was also some evidence of backsliding, as well as some difficult cases involving GORRs structured as security for payments under a purchase and sale agreement.

As an example of the first, we have the recent decision in *Bacanora Minerals Ltd v Orr-Ewing*, [2021 ABQB 670 \(CanLII\)](#), in which Justice John T. McCarthy, drawing on earlier and surely discredited authority, seems to have reverted to a search for magic words in construing a royalty clause in a minerals agreement:

In my view, the wording of the GOR is similar to the agreements discussed in *Vandergrift* and *Vanguard* in that the royalty is based upon minerals “obtained” (ie: “recovered” or “found”, as per *Vandergrift*) and, similar to *Vanguard*, is based upon their value following their removal from the land (as per the definition of “Products” being “produced from” and the definition of “Revenue”). As such, the wording of the GOR and related agreements is not precise enough to create an interest in land. Rather, it provides Mr. Orr-Ewing with a right to payment calculated on production of ore (lithium) from the Assets, as defined. It does not appear to grant a property interest in the produced minerals, nor any profit-a-prendre for the grantee. It is a contractual right to the payment of a 3% royalty. (at para 79, per Justice McCarthy)

As an example of the second, we have Justice Horner’s decision in *Accel Canada Holdings Limited (Re)*, [2020 ABQB 182 \(CanLII\)](#) (leave to appeal on the interest in land issue [2020 ABCA 160](#) rejected.) In my view the unusual structure and commercial purpose of these agreements justified Justice Horner’s conclusion that neither GORR at issue in that case was intended to create an interest in land.

Justice Bourque’s Review

Given this background, Justice Bourque’s careful review and application of the authorities is especially welcome.

Justice Bourque’s starting point was to say that “[w]here a royalty agreement expressly states that the royalty in question constitutes an interest in land, is to be construed as an interest in land, or runs with the lands subject to the royalty or the underlying interest in land” this “creates a strong, but rebuttable presumption that the royalty is indeed an interest in land. After all, it is a cardinal principle of contract interpretation that the parties intend what they have said ...”. (at para 63)

And, in this case, there was nothing to rebut this presumption. The circumstances surrounding the execution of the GORR made it clear that it was important to the parties that the GORR would run with the land and bind subsequent purchasers (at paras 73 – 80). Furthermore, there was nothing in the granting clause to rebut the presumption created by the interest in land clause: “[w]hether a GOR is framed as an interest in the *in situ* resource or as a share of the resources extracted from the lands is not determinative of the parties’ intention to convey an interest in land.” (at para 87). The interest in land clause was a strong indication of intention and the fact that it referred to caveating the GORR could not detract from this even though there was no possibility of caveating a royalty interest in Crown minerals (at para 93, see further discussion below). The surrender clause of the agreement reinforced the view that the GORR “was an investment in the success of

a “particular piece of property’, as opposed to an extinguishable mechanism for the repayment of a debt” (at para 99). The existence of a right to take in kind was neutral (at para 102), and the same was true of the pooling and unitization provisions of the GORR (at paras 103 – 108).

Perhaps of most interest was the discussion of the assignment provisions of the GORR. These provisions incorporated by reference the CAPL assignment procedure, which is designed to effect an assignment and novation (A & N) by way of a notice and deemed consent (absent an objection). It was Yangarra’s position that this must be evidence that the GORR did not need to be an interest in land, because the GORR would become binding upon an assignee by virtue of the A & N procedure and not by virtue of it being an interest in land. Justice Bourque rejected that position. Rather he held that:

... the incorporation of the CAPL Assignment Procedure under the 2011 Royalty Agreement reflects the industry practice of perfecting the assignment of the payor’s interest in a royalty agreement, regardless of whether the royalty would presumptively run with the subject lands. (at para 115)

In sum, the intentions of the parties, as revealed in the text of the agreement and as supported by the surrounding circumstances and industry practice, all contributed to the conclusion that the GORR was an interest in land that was intended to endure for the full duration of the Crown lease out of which it was carved.

Issue # 2. Insofar as the GORR is an Interest in Land, What are the Rules for Determining Whether the GORR Binds a Subsequent Assignee of the Working Interest (the Lease)?

There is one well recognized way to make an interest like a GORR bind subsequent assignees of the working interest, and that is to have the parties execute an assignment and novation agreement (A & N Agreement). An A & N Agreement serves to create privity of contract between the assignee of the working interest and the holder of the GORR. In this case however, the evidence suggested that while A & N Agreements had been executed for many agreements in the lengthy chain of title (including an earlier GORR), the HQ GORR had somehow been missed (at para 15). This was why PrairieSky needed to show that the HQ GORR was an interest in land.

But that could not be a complete answer; it was also necessary for PrairieSky to show that Yangarra was bound by the GORR as an interest in land, and to answer that question we need to understand the applicable rules for resolving disputes between competing interests.

The Applicable Rules

The first distinction that we must make is the distinction between unpatented Crown lands and lands brought within the *Land Titles Act*, [RSA 2000, L-4 \(LTA\)](#). If the mineral lands in question had been patented and a certificate of title issued for those lands, then, in order to protect the GORR against a subsequent assignee of the working interest, the holder of the GORR would need to file a caveat. The GORR in this case would be a caveatable interest because it is an interest in land (*LTA*, s 130). Absent a caveat, the purchaser of the working interest would be entitled to take, free and clear of the GORR, except in the case of fraud wherein the purchaser had participated (*LTA*,

ss 53, 60, 62 and 203; *Holt, Renfrew & Co Limited v Henry Singer Limited*, [1982 ABCA 135 \(CanLII\)](#)). This is not the place to canvas what might constitute fraud, but fraud would include a situation in which a purchaser covenanted to observe a prior interest, or a situation in which the interest purchased was said to be subject to certain outstanding interests.

But the important point for present purposes is that the mineral lands in question were unpatented Crown lands for which no certificate of title had ever been issued. As a result, the rules of the *LTA* are simply inapplicable. I think that this follows from the general structure of the *LTA* for all unpatented Crown lands (see, for example *Paulette et al v The Queen*, [1976 CanLII 200 \(SCC\)](#), [1977] 2 SCR 628,) but it also follows from two specific provisions of Alberta's *LTA*: s 134(2) and s 202.

Section 134(2) prevents the Registrar from registering a caveat against "land for which no certificate of title has been issued", while s 202 expressly addresses the situation where mineral rights are owned by the Crown:

202 When the Crown is the owner of a mineral

(a) no person shall register, nor shall the Registrar accept for registration any lease, assignment, caveat or encumbrance affecting that mineral or any interest in it, and

(b) the Registrar may correct the register by cancelling the registration of a lease, assignment, caveat or encumbrance insofar as it affects a Crown mineral or any interest in it and by making any necessary memorandum or endorsement on the certificate of title and on any other instrument.

In the case of Crown lands therefore, our inquiry must extend beyond the *LTA* to any specific provisions of the relevant Crown resource or public lands legislation, as well as any general principles of law and equity when trying to resolve disputes between competing interests. I wrote about these issues nearly 40 years ago, in a couple of places: see *The Assignment and Registration of Crown Mineral Interests with Particular Reference to the Canada Oil and Gas Act*, CIRL Working Paper (1995), and "The Registration and Transfer of Crown Mineral Interests" in Nigel Bankes and JO Saunders, eds, *Public Disposition of Natural Resources*, (Calgary: Canadian Institute of Resources Law, 1984) at 89 – 107. My sense is that not much has changed; but that is the nature of property law!

Part 6 of the *Mines and Minerals Act*, [RSA 2000, c M-17 \(MMA\)](#) contains a registry system for Crown mineral interests, but it is far less comprehensive than that offered by the *LTA*. In particular, the scheme only allows for the registration of two types of interests: (1) transfers of an entire agreement (leases), transfers of an undivided interest in an agreement, and transfers of part of the location of an agreement (at s 91), and (2) security notices in respect of a security interest (at s 95). A GORR is therefore not registerable in the Department of Energy's register. A GORR may be an interest in land, but it is certainly not an undivided interest in land because the holder of the GORR is not a tenant in common of the rights granted by the lease (see *St Lawrence Petroleum Limited et al v Bailey Selburn Oil & Gas Ltd et al*, [1963 CanLII 76 \(SCC\)](#), [1963] SCR 482). And neither

is a conventional GORR a security interest, unless the GORR is granted as security for an indebtedness which is not ordinarily the case (but see *Accel*, above).

On the other hand, the interest that a party like Yangarra obtains by way of an assignment of a lease, or an assignment of an undivided interest in that lease, is registerable and s 91(5) of the *MMA* provides that when such an interest is registered that interest or transfer “is valid against and prior to any unregistered transfer”.

If the GORR is an unregistrable interest in land, it follows that the validity and priority of that interest must be determined according to the rules of common law and equity, and not by the provisions of the *MMA*.

An interest in land may be legal or equitable. A legal interest binds the whole world regardless of notice. An equitable interest binds the whole world save for equity’s darling, the *bona fide* purchaser of a legal estate, without notice of a prior equitable interest.

It seems pretty clear (but see the discussion below) that a person in Yangarra’s position acquires a legal estate if they take an assignment of the lease, or an undivided interest in the lease, by way of a written assignment and they register that assignment in the Department’s registry. After all, if they do that, they have complied with all of the requirements prescribed by the *MMA*.

But what about the HQ GORR? In principle, the GORR could be either a legal or an equitable interest. It could be a legal interest if it complied with all requirements prescribed by law.

Where do we find those requirements? I think that we find them in the old statutory rules still in force in Alberta, namely the *Statute of Frauds*, (1677)29Car 11, c 3 (ss 1 and 3) and the *Imperial Law of Property Act* (1845) 8 & 9 Vict, c 106, and thus the GORR should be in writing and under seal. For further discussion see Alberta Law Reform Institute, *Statute of Frauds and Related Legislation*, [1985 CanLIIDocs 2](#).

If the GORR were not under seal it could still take effect as an equitable interest, subject to its vulnerability as against equity’s darling.

Justice Bourque’s Application of the Relevant Rules

Justice Bourque’s analysis confirms much of the above. He concluded that the GORR was not registrable since it was neither the transfer of an undivided interest in the agreement nor a security interest (at paras 121 – 128). But his analysis of whether the GORR gave rise to a legal or an equitable interest in the lands is cursory and less convincing. Indeed, in part at least, he seems to have assumed that if the GORR gave rise to an interest in land rather than a mere contractual interest then the resulting interest must be a legal interest:

As previously discussed, the 8% Royalty is no mere contractual, *in personam* right — it is a proprietary interest in land (see paragraph [88]) that is legally recognizable by virtue of satisfying the common law *Dynex* test for a royalty that constitutes an interest in land.

The 8% Royalty is therefore a legal interest, or an *in rem* right, that runs with the lands and is enforceable against the underlying interest in land. (at para 133)

In my view, this particular statement conflates the relevant rules.

That said, Justice Bourque does go on, more convincingly, to say that the parties to the GORR did comply with the relevant legal rules, although he refers (at para 134) to s 4 of the *Statute of Frauds* rather than ss 1 and 3. Section 4 represents a lesser standard for the enforceability of any agreement in relation to land; it does not prescribe the relevant standards for establishing a legal interest although it might allow the enforcement of informal agreement so long as evidenced in writing signed by the person against whom it was to be enforced: see *Walsh v Lonsdale* (1882), 21 Ch D 9.

Justice Bourque rejected Yangarra's argument (at paras 135 – 137) that the GORR could only give rise to an equitable interest in land because it was in some sense contingent: *London & South Western Ry Co v Gomm*, (1882) 20 Ch D 562, [1882] 3 WLUK 13 (and see also *Canadian Long Island Petroleum Ltd et al v Irving Industries Ltd*, [1974 CanLII 190 \(SCC\)](#), [1975] 2 SCR 715). I agree with Justice Bourque's conclusion. The GORR gives rise to an interest that vests immediately and is thus not a contingent interest even though both its value and its duration might be contingent on actual production.

Since Justice Bourque concluded that the GORR gave rise to a legal interest in the land, he did not need to consider what the result might have been had the interest proven to be merely equitable. That is perhaps unfortunate since Justice Bourque clearly heard extensive submissions on the matter, and the oil and gas bar might have benefited from a discussion of the application of the rules pertaining to actual and constructive notice in the context of title review for purchase and sale agreements and encumbrances such as GORRs (at paras 149 – 150 and 154 - 155).

Justice Bourque did however consider an alternative argument of PrairieSky to the effect that Yangarra had not acquired a legal estate since there was no proof that Yangarra had ever paid the \$1.00 purchase price required by the relevant purchase and sale agreement (PSA). Justice Bourque ultimately rejected this argument, principally on the grounds that neither party to the PSA was seeking to repudiate the agreement (at para 142). But perhaps the more important point was that Yangarra's interest was registered in the Department's register, thereby curing any technical defect in its title, and even if that were not the case (and I recognize that this claim might be contested since the *MMA* is a not a Torrens-style guarantee of title) it was surely not a defect that could make Yangarra's title "unenforceable" at the instance of a third party (PrairieSky) as PrairieSky seems to have suggested (at para 144).

Conclusion

Justice Bourque gave judgment for PrairieSky. He made a declaration that the GORR was enforceable against Yangarra, awarded damages based on the application of the royalty formula to Yangarra's production as apportioned to the subject lands, and granted an order with respect to future production volumes and prices (which is perhaps a little unusual since it might involve the court in continuing supervision).

The judgment will help clarify the actual application of *Dynex* to GORR agreements and will provide guidance to those drafting such agreements.

This post may be cited as: Nigel Bankes, “The Legal Status of a Gross Overriding Royalty Carved out of a Crown Lease” (January 10, 2023), online: ABlawg, http://ablawg.ca/wp-content/uploads/2023/01/Blog_NB_PrairieSky.pdf

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