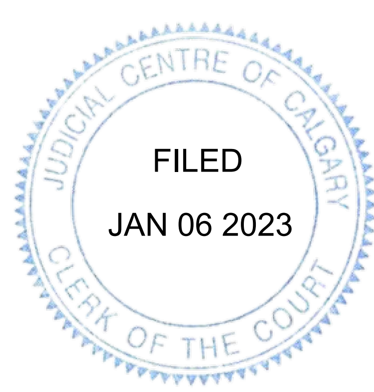

Court of King's Bench of Alberta

Citation: Prairiesky Royalty Ltd v Yangarra Resources Ltd, 2023 ABKB 11

Date:
Docket: 1701 08362
Registry: Calgary

Between:

Prairiesky Royalty Ltd.

Plaintiff

- and -

Yangarra Resources Ltd.

Defendant

Reasons for Judgment
of the
Honourable Justice M.H. Bourque

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I. Introduction

[1] The overarching question before me is whether the successor in interest to a Crown petroleum and natural gas lease is bound by an overriding royalty that was originally granted by a predecessor lessee as consideration for the funding for the acquisition of the lease.

[2] The Plaintiff, PrairieSky Royalty Ltd. ("PrairieSky"), is the successor to the original grantee's interest in an April 1, 2011 Royalty Agreement (the "2011 Royalty Agreement") under which an 8% overriding royalty (the "8% Royalty") was granted in respect of oil and gas recovered under Crown Petroleum and Natural Gas Lease No. 0579030039 (the "Crown Lease"). The 8% Royalty grantor's undivided interest in the underlying Crown Lease was transferred to Relentless Resources Ltd. ("Relentless") in 2013. The Defendant, Yangarra Resources Ltd. ("Yangarra"), acquired Relentless' interest in the Crown Lease in 2016.

[3] PrairieSky seeks a declaration that Yangarra is bound by the 8% Royalty and monetary judgement against Yangarra for outstanding royalty payments plus interest. In its defence, Yangarra asserts that the 8% Royalty is not an interest in land that could run with the lands subject to the Crown Lease and, therefore, could not encumber subsequent lessees. In the alternative, if the 8% Royalty *does* constitute an interest in land, Yangarra asserts it is a *bona fide* purchaser for value without notice ("BFPV") under the law of equity and, therefore, should not be bound by the 8% Royalty.

[4] This is a case where the Torrens system of land registration and transfers is not determinative of the priority of the competing interests. Certificates of title are generally not issued for Crown-owned lands. Further, caveats and other encumbrances that can otherwise be registered to provide notice to potential purchasers of an overriding royalty on freehold minerals cannot be registered against Crown-owned minerals pursuant to s 202(a) of the ***Land Titles Act***, RSA 2000, c L-4 (the "*LTA*"). Therefore, to determine whether the defence of BFPV applies here, the Court must determine the nature of the parties' interests — legal or equitable — and apply the common law rules of priority to PrairieSky's prior interest in the form of the 8% Royalty and Yangarra's subsequent interest in the Crown Lease.

[5] For the reasons that follow, I find that the 8% Royalty arising from the 2011 Royalty constitutes an interest in land. I have also found that each of the 8% Royalty and Yangarra's interest in the Crown Lease are legal interests. Given that it was first in time, the 8% Royalty has priority over Yangarra's interest in the Crown Lease.

II. Issues

[6] To determine whether Yangarra is bound by the 8% Royalty, the following issues must be resolved:

Issue 1: Does the 8% Royalty arising from the 2011 Royalty Agreement constitute an interest in land?

Issue 2: If the 8% Royalty is an interest in land, does it have priority over Yangarra's interest in the Crown Lease? To determine this issue, the following sub-issues must individually be determined:

(i) Are the parties' interests legal or equitable?

(ii) As two legal interests, does PrairieSky's 8% Royalty have priority over Yangarra's interest in the Crown Lease?

Issue 3: What remedy, if any, is appropriate?

III. Background Facts

[7] The Crown Lease conferring "the exclusive right to explore for, work, win and recover petroleum and natural gas within and under" the Southwest ¼ Section 7, Township 41, Range 5, West of the Fifth Meridian in Alberta (the "Royalty Lands") was initially granted to Westhill Resources Limited ("Westhill") and O'Sullivan Resources Ltd. ("O'Sullivan") in 1979. Upon obtaining the Crown Lease, Westhill and O'Sullivan entered into a royalty agreement (the "1979 Royalty Agreement") with Success Oil Ltd. ("Success"), under which a 2% gross overriding royalty was granted in respect of petroleum substances produced, saved, and sold after the date thereof from the Royalty Lands (the "2% GOR"). While the status of the 2% GOR in this case is not in dispute, its treatment throughout the various transfers of interest in the Crown Lease and the 1979 Royalty Agreement provide useful context for the status and treatment of the 8% Royalty in question.

[8] The Lands subject to the Crown Lease were further circumscribed by deep rights reversion in 1984, which excluded petroleum and natural gas rights below the base of the Cardium Formation. The Crown Lease thus encompasses petroleum and natural gas to the base of the Cardium Formation. As unpatented Crown lands, there is no certificate of title associated with the Lands that otherwise exists for freehold minerals pursuant to the *LTA*.

[9] By September 28, 1987, the Crown Lease had been transferred to Trarion Resources Ltd. ("Trarion"), and Solar Energy Resources Ltd. had succeeded Success in its interest in the 1979 Royalty Agreement and the underlying 2% GOR.

[10] On April 1, 2011, Home Quarter Resources Ltd. ("Home Quarter") entered into a Purchase and Sale Agreement with Trarion, through which Home Quarter acquired Trarion's 100% interest in the Crown Lease. On April 1, 2011, Trarion assigned its interest in the 1979 Royalty Agreement to Home Quarter via an assignment and novation agreement. The transfer of the Crown Lease from Trarion to Home Quarter was registered by the Minister of Energy pursuant to s 91(1) of the ***Mines and Minerals Act***, RSA 2000, c M-17 (*MMA*) on May 11, 2011.

[11] On April 1, 2011, Home Quarter also entered into the 2011 Royalty Agreement with Range Royalty Limited Partnership ("Range Royalty"). Under the 2011 Royalty Agreement, Home Quarter granted the 8% Royalty to Range Royalty pursuant to an ongoing land fund arrangement between the parties. The arrangement entailed Range Royalty funding Home

Quarter's acquisition of various lands in consideration for the reservation of a royalty (the "Land Fund Arrangement"). The nature of the Land Fund Arrangement and the standard form royalty agreement used thereunder are discussed further at paragraphs [74]–[78].

[12] On June 11, 2013, Home Quarter entered into an Asset Exchange Agreement with Relentless Resources Ltd. ("Relentless"), through which it conveyed its 100% interest in the Crown Lease to Relentless. Home Quarter also transferred its interest in the 1979 Royalty Agreement to Relentless via a June 20, 2013 Assignment and Novation Agreement, and its interest in the 2011 Royalty Agreement to Relentless pursuant to a Notice of Assignment.

[13] Effective December 19, 2014, PrairieSky acquired Range Royalty, assuming all its rights, liabilities, obligations, property, and assets by way of a plan of arrangement. As a result, PrairieSky became the successor to Range Royalty's interest in the 2011 Royalty Agreement and the underlying 8% Royalty. The same day, PrairieSky issued a "Notice to Industry" informing all of Range Royalty's contractual counterparties — including Relentless and Yangarra — of its acquisition of Range Royalty, and advising that all notices, correspondence, documentation, invoices, or payments related to contracts with Range Royalty should be directed to PrairieSky.

[14] By 2016, Yangarra held the lands adjacent to the Royalty Lands subject to the Crown Lease. Yangarra wanted to maximize the acreage across which it could drill a horizontal well in the area. Accordingly, Yangarra's Vice President of Land, Mr. Faminow, approached Relentless — the lessee at that time — about acquiring the Crown Lease. Yangarra originally offered to acquire the Crown Lease and an existing well, 102/04-07-041-05W5 (the "4-7 Well"), for $500. The purchase price was ultimately lowered to $1.00, however, after Yangarra obtained an environmental site evaluation of the 4-7 Well site, which revealed some potential environmental liabilities that Yangarra would have to assume.

[15] Following an expedited period of due diligence, on June 13, 2016, Yangarra and Relentless executed an Agreement of Purchase and Sale for the Crown Lease and the 4-7 Well. The transaction closed on June 17, 2016, at which point Relentless and Yangarra had entered into an Assignment and Novation Agreement under which Relentless assigned its interest in the 1979 Royalty Agreement to Yangarra. The 2011 Royalty Agreement, however, was missed in due diligence and was never formally assigned by Relentless to Yangarra.

[16] A horizontal well was eventually drilled into the Royalty Lands (the "4-7 Horizontal Well") after Yangarra had acquired the Crown Lease from Relentless and commenced production in October, 2016. After discovering the well and the nonpayment of the 8% Royalty, on May 11, 2017, PrairieSky sent a demand notice to Yangarra and Relentless requesting payment of the outstanding royalties attributable to the production allocated to the portion of the well producing from the Royalty Lands. In response, Yangarra asserted that it is not bound by the 8% Royalty.

IV. Issue 1: Does the 8% Royalty arising from the 2011 Royalty Agreement constitute an interest in land?

A. Legal Framework

[17] When an owner of the mines and minerals leases the rights to extract the resources from the land to a third party, they will often reserve for themselves an unencumbered share or interest in the minerals or petroleum substances produced by the lessee. This is referred to as a "royalty

interest" or a "lessor's royalty". When a lessee or holder of the working interest in the *in situ* minerals grants an unencumbered share or interest in the minerals or petroleum substances produced to a party in exchange for money or other services, that interest is called an "overriding royalty" or a "gross overriding royalty" (hereinafter referred to as "GORs"; ***Dynex***, *infra*, at para 2).

[18] The concept of a GOR is concisely described in ***Curry v Athabasca Resources Inc***, 2022 SKKB 221 at para 41, citing Michael A Thackray, *Canadian oil and gas*, loose-leaf (Rel 186, Nov 2021) 3d ed, vol 1(Vancouver: LexisNexis, 2017) [Thackray] at § 7.67:

> The overriding royalty is the right to take, in kind or money, a share of future mineral production from a well without the obligation to pay a proportionate share of drilling or producing costs. The overriding royalty is limited to an interest in the production of specified substances from the land and does not include any of the possessory rights normally associated with a working interest. This type of royalty is extremely versatile and is used as a means of raising funds, providing incentives, or spreading risk by retaining an economic interest in a mineral prospect without retaining any associated liability (such as in a farmout). This versatility has led to a great variation in the language found in royalty agreements and a royalty agreement may consist of a two or three-sentence letter or a lengthy and complex document.

[19] The present case concerns a GOR granted by the lessee of Crown-owned minerals to a royalty company as consideration for the royalty company funding the acquisition of the lease.

1. Gross overriding royalties as interests in land

[20] The contemporary test for determining whether a royalty interest is an interest in land was articulated by Virtue J of this Court in ***Vandergrift v Coseka Resources Ltd***, 1989 CanLII 3163 (ABQB) at para 29, 67 Alta LR (2d) 17 [***Vandergrift***], and was later adopted by Major J, for a unanimous Supreme Court of Canada, in ***Bank of Montreal v Dynex Petroleum Ltd***, 2002 SCC 7 [***Dynex***], aff'g ***Bank of Montreal v. Enchant Resources Ltd.***, 1999 ABCA 363 [***Dynex ABCA***][1] at para 22 (the "***Dynex*** test"):

> …under Canadian law a "royalty interest" or an "overriding royalty interest" can 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.

[21] However, the question of whether royalties carved out of oil and gas leases can constitute interests in land has been debated since the earliest days of western Canada's oil and gas industry

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[1] The style of cause of the Alberta Court of Appeal decision is *Bank of Montreal v. Enchant Resources Ltd.*, whereas the style of cause *Bank of Montreal v. Dynex Petroleum Ltd.* was used for both the trial decision and the Supreme Court of Canada decision. As far as I am aware, the Supreme Court of Canada decision is always referred to as *Dynex*; however, the Court of Appeal decision is occasionally referred to as *Enchant*. To assist the reader and avoid confusion, I have defined the Court of Appeal decision as *Dynex ABCA*.

(see *e.g.*, ***Publix Oil and Gas Limited (Re)***, 1936 CanLII 422 (ABCA), [1936] 3 WWR 634). The growing pains of "trying to come to grips with some of the novel legal problems created by the industry's presence in our country" were amplified by the application of English common law concepts of property that were "developed in vastly different circumstances"(***Scurry-Rainbow Oil Limited et al v Galloway Estate et al***, 1993 CanLII 7025 (ABKB) [***Scurry-Rainbow***] at para 17, 8 Alta LR (3d) 225; aff'd, 1994 ABCA 313; leave to appeal denied, [1994] SCCA No 475). Such an approach risked outcomes that were "out of touch with the realities of the industry and that deviate[d] from the sorts of solutions needed by the affected parties" (***Scurry-Rainbow*** at para 17).

[22] Notwithstanding the practical approach of Canadian courts toward upholding the intention of industry practices over adherence to the old common law, anachronistic common law strictures of property rights continue to arise in arguments under the guise of new facts. The present case is no different. The following review of the development and current state of the law is thus intended to provide context for the arguments made on the specific facts in this case.

a) Whether the underlying interest is an interest in land

[23] With respect to the second arm of the ***Dynex*** test, the common law once held that an interest in land could only be derived from a corporeal hereditament, and not an incorporeal hereditament (see ***Berkheiser v Berkheiser and Glaister***, 1957 CanLII 56 (SCC), [1957] SCR 387 [***Berkheiser***] at 390; see also discussion of Laskin J (dissenting), in ***Saskatchewan Minerals v Keyes***, 1971 CanLII 183 (SCC), [1972] SCR 703 [***Saskatchewan Minerals***] at 721–722). The Ontario Court of Appeal recently described the difference between the two in ***Third Eye Capital Corporation v Ressources Dianor Inc***, 2018 ONCA 253 [***Dianor***] at para 31:

> A corporeal hereditament is an interest in land that is capable of being held in possession, such as a fee simple. An incorporeal hereditament is an interest in land that is non-possessory such as easements, *profits à prendre*, and rent charges. Under each type of incorporeal hereditament, the holder has an interest in land.

[24] The prohibition on the issuance of an interest in land from an incorporeal hereditament had to do in large part with the remedy of distress. Distress allows for the seizure of someone's property as security for the performance of an obligation. A royalty carved directly from a lessor's mineral rights — a corporeal hereditament — in consideration for the lessee's right to take minerals from the land — an incorporeal hereditament — has been analogized to a rent charge (***Dynex ABCA*** at para 59). Ordinarily, a lessor's right to distrain in the event of a lessee's default was a necessary incident of a rent. In the case of leases for upstream oil and gas ventures, however, the "idea that royalty owners could summarily seize drilling and producing equipment worth millions of dollars, especially in fields where drainage might be going on, is unthinkable" (***Dynex ABCA*** at para 64, citing WH Ellis, "*Property Status of Royalties in Canadian Oil and Gas Law*" (1984) 22 Alta L Rev 1 at 10). A lessor's royalty and overriding royalties are thus without the right of distrain.

[25] Absent the right of distrain, "the argument goes, a royalty cannot be treated as rent nor can an overriding royalty" (***Dynex ABCA*** at para 63). In result, royalty interests arising from a working interest in third-party mineral rights — such as oil and gas or mining leases — were not considered interests in land (see Alicia K Quesnel, "*Modernizing the Property Laws that Bind Us: Challenging Traditional Property Law Concepts Unsuited to the Realities of the Oil and Gas Industry*" (2003) 41 Alta L Rev 159, at pp 172–173).

[26] In the seminal case of ***Berkheiser***, however, the Supreme Court of Canada characterized an oil and gas lease as a *profit à prendre* (*i.e.*, the right to take something from another's land) and held that such leases *can* be interests in land (at 392). Notwithstanding the ***Berkheiser*** Court's break from the old common law, litigants continued to argue — and some judges agreed — that an interest in land could not issue from an incorporeal hereditament such as a *profit à prendre*, including oil and gas and mining leases (see ***Dynex ABCA*** at para 22 and ***Dynex*** at para 9).

[27] Upon considering overriding royalties arising from oil and gas leases in ***Dynex***, however, the Supreme Court definitively dispatched with the "common law prohibition on the creation of an interest in land from an incorporeal hereditament" (at paras 18–21). By extension, a contract conferring a royalty interest does not need to give the royalty holder an interest in the reversion or the right of distrain for the royalty to constitute an interest in land (***McDonald v Bode Estate***, 2018 BCCA 140 at paras 43, 45, citing ***Dynex*** at para 11). The Court held that, "[g]iven the custom in the oil and gas industry and the support found in case law, it is proper and reasonable that the law should acknowledge that an overriding royalty interest can, subject to the intention of the parties, be an interest in land" (***Dynex*** at para 18).

[28] The ***Dynex*** Court, at para 6, endorsed the policy reasons reviewed by the Alberta Court of Appeal as the basis for concluding that overriding royalties can be interests in land (***Dynex ABCA*** at paras 34–45). These non-exhaustive reasons can be summarized as follows:

- Royalties routinely play an integral role in financing oil and gas ventures, which often involve huge capital costs and high risk. By spreading the financial risk among different stakeholders, royalties also serve to stabilize industry volatility (***Dynex ABCA*** at para 34).
- The risked-capital of a single high-stakes oil and gas venture may be too great to justify the investment. Royalties offer an enticing alternative for the investor who "is betting that the many losses will be made up by the small fraction of successes" (***Dynex ABCA*** at para 35).
- Royalties may be "used to compensate employees whose efforts determine the success of a project", but who otherwise might lack the capital to finance the project themselves (***Dynex ABCA*** at para 34).
- The success of an upstream oil and gas venture depends, to a large degree, on the subsurface geology of a specific location. Royalties offer a means of investing in the geologic prospectivity of "a particular piece of property" instead of "a particular operator or company" for which there are other means of investing. "The investment return on a royalty results from the success of the property regardless of who owns or is working the property" (***Dynex ABCA*** at paras 35–36).
- Non-operating interests such as royalties further mitigate the high risks associated with oil and gas ventures by defining how the benefits of mineral ownership are shared, by minimizing taxes, and by delegating operatorship and allocating risks and rewards "without invoking many objectionable features associated with creating a conventional business association" (***Dynex ABCA*** at para 43).
- If royalties were not considered interests in land, they would extinguish upon the transfer of the underlying lease to a third party, rendering the lease more valuable to the successor lessee who is not obligated to pay the royalty. This may create a

> perverse incentive for creditors holding their debtors' leases as security to petition them into unnecessary bankruptcies to realize the increased value of liquidated leases formerly encumbered by royalties (***Dynex ABCA*** at para 45).

b) The intention of the parties to create an interest in land

[29] Given that a *profit à prendre* can be an interest in land, the second part of the ***Dynex*** test is easily satisfied in the case of royalties carved from mineral leases that confer on the lessee the right to extract minerals or petroleum substances from the land. Disputes since ***Dynex*** have instead largely focused on the first part of the test and interpreting whether the parties intended to create an interest in land.

(1) The *Vandergrift* approach

[30] To understand the uncertainty that has continued to follow royalties as interests in land since ***Dynex***, it is useful to start with the ***Vandergrift*** decision. Though ***Vandergrift*** laid out the modern test for royalties as interests in land, it still applied antiquated common law strictures of real property to the intention-of-the-parties analysis. Notwithstanding the fact that the royalty agreement in ***Vandergrift*** provided that "[a]ll terms and conditions of this Agreement shall run with and be binding upon the lands", the trial judge held that the contract's language and the absence of traditional incidents of an interest in land defeated its characterization as an interest in land.

[31] Emphasis was placed on the fact that the recitals of the royalty agreement in question described the royalty as a "gross overriding royalty on all petroleum substances recovered from the lands" instead of "petroleum within, upon, and under the lands" (***Vandergrift*** at paras 35–26). The gross overriding royalty was subsequently defined in the body of the agreement as an interest "in all petroleum substances <u>found</u> within, upon or under the lands" (paras 35–36, emphasis added). This was taken to connote an interest in the petroleum after it had been "found" (presumably by the drill bit) and extracted from the subsurface, not as an interest in the petroleum substances *in situ* (at para 36).

[32] The remaining references to the gross overriding royalty in the agreement spoke of "a share in production", "petroleum substances sold", and "petroleum substances produced". Relying on previous authorities, the trial judge in ***Vandergrift*** couched the language in those references as conveying an intent to create a contractual interest in petroleum substances severed from the lands as opposed to an interest in land itself (at para 36, citing ***Vanguard Petroleums Ltd v Vermont Oil & Gas Ltd***, 1977 CanLII 648 (ABKB) at para 19, 72 DLR (3d) 734, and ***Emerald Resources Ltd v Sterling Oil Properties Mgmt Ltd***, 1969 CanLII 803 (ABCA), 3 DLR (3d) 630 at 640, aff'd 1970 CanLII 980 (SCC)).

[33] The trial judge also found that the absence of certain traditional incidents of an interest in land affirmed the royalty's mere contractual nature. If the royalty *did* create an interest in land, the trial judge reasoned that one would expect the royalty holders to have the "right to enter upon the lands to explore for and extract the minerals" (***Vandergrift*** at para 38). Further, the royalty agreement provided that "nothing herein shall be construed as requiring [the royalty grantor] to conduct exploratory operations or to drill a well on the lands" (at para 35). In other words, not only could the royalty holders not extract the minerals themselves, but they couldn't compel the grantor to do so either (at para 38). The trial judge found this fatal to the interest being

characterized as an interest in land, which harkens to the old common law requirement that the interest holder have some measure of control over the interest in question for it to be characterized as an interest in land (see, *e.g.*, ***St. Lawrence Petroleum Limited et al v Bailey Selburn Oil & Gas Ltd et al***, 1963 CanLII 76 (SCC), [1963] SCR 482 at 489–491 [***St. Lawrence Petroleum***]).

[34] While the Supreme Court adopted the two-part test articulated by Virtue J in ***Vandergrift***, it did not directly grapple with the ***Vandergrift*** decision's application of old common law concepts in the intention-of-the-parties analysis. Consequently, there has been lingering uncertainty as to whether a royalty can be an interest in land if the royalty agreement doesn't (a) describe the interest with words to the effect of "in, under, or upon the land", and (b) include a royalty holder's right to enter upon the lands and extract the resources (see *e.g.*, ***St Andrew Goldfields Ltd v Newmont Canada Limited***, 2009 CanLII 40549 at paras 102–104, [2009] OJ No 3266, aff'd 2011 ONCA 377 [***St. Andrew Goldfields***]; ***Third Eye Capital Corp v Dianor Resources Inc***, 2016 ONSC 6086 at paras 25–30; ***Bacanora Minerals Ltd v Orr-Ewing***, 2021 ABKB 670 at paras 74–80).

[35] Nevertheless, the ***Dynex*** decision upheld the underlying decision of the Alberta Court of Appeal in ***Dynex ABCA***, which addressed these issues head-on.

(2) The *Dynex ABCA* Approach

[36] The Alberta Court of Appeal stressed that the intention of the parties to establish either a contractual interest or an interest in land must be assessed "from the agreement as a whole, along with the surrounding circumstances, as opposed to searching for some magic words" (***Dynex ABCA*** at para 73). This was based on the practical approaches of Laskin J (dissenting) in ***Saskatchewan Minerals*** (also cited approvingly in ***Dynex***, at paras 10–12); Matheson J in ***Canco Oil & Gas Ltd v Saskatchewan***, 1991 CanLII 7788 (SKQB), [1991] SJ No 22 (QL) [***Canco***]; and Hunt J in ***Scurry-Rainbow***.

[37] In ***Saskatchewan Minerals***, Laskin J held, at 725 (emphasis added):

> The words in which [a royalty] is couched may show that only a contractual right to money or other benefit is prescribed. However, if the analogy is to rent, then the fact that the royalty is fixed and calculable as a money payment based on production or as a share of production, or of production and sale, cannot alone be enough to establish it as merely a contractual interest.

[38] Matheson J held the following in ***Canco*** at para 58 (emphasis added):

> The consideration for the grant … of the 3% gross royalty was not expressed as relating to any right to enter, explore and remove petroleum substances from the designated lands. Whatever may have been the true consideration, surely the principal questions are whether [the royalty grantor] was capable of granting an interest in the lands and whether it intended to do so and whether it accomplished that intention. As owner of a designated interest in mines and minerals in fee simple [the royalty grantor] clearly possessed an interest in the lands, and the wording of the Royalty Agreement permits of no other conclusion but that [the royalty grantor] intended that the grant of the 3% gross royalty should constitute an interest in the lands. The fact that [the royalty grantor] did not utilize all of the wording, or type of wording, considered by some persons as perhaps essential,

> can surely not detract from an otherwise clearly manifested intention to create an interest in the lands.

[39] And in ***Scurry-Rainbow***, Hunt J held, at 474:

> There is in my view an unreality about placing too heavy an emphasis upon fine distinctions as the selection of words such as "in" rather than "on". Notwithstanding the significance that the courts have sometimes attached to these word choices, I doubt that parties who signed leases …should be taken to have intended to create an interest in land as opposed to a contractual right, as a result of such minuscule differences in language….Rather, it is more appropriate to consider the substance of the transaction (namely, what were the parties actually trying to achieve?) and to regard the words they have used from that perspective.

[40] After reviewing primary and secondary authorities in Canada and the US, the Court of Appeal in ***Dynex ABCA*** came up with a non-exhaustive list of indicia that can be used to identify whether a royalty was intended to be an interest in land (at para 84):

1. The underlying interest is an interest in land (corporeal or incorporeal);
2. The intentions of the parties, as evidenced by the language of the grant and any admissible evidence of the surrounding circumstances or behaviour, indicate that it was understood that an interest in land was created/conveyed;
3. The interest is capable of lasting for the duration of the underlying estate.

(3) ***Dianor*'s clarification of the *Dynex* test**

[41] In ***Dianor***, the Ontario Court of Appeal reconsidered the ***Dynex*** decision in light of the trial judge's application of the ***Vandergrift*** approach, which it described as "a serious misapprehension … in the application of ***Dynex***" (para 68). As I have also noted in paragraph [34], ***Dynex*** merely adopted the test laid out in ***Vandergrift*** — it did not adopt its reasoning (***Dianor*** at para 69).

[42] The Ontario Court of Appeal clarified that the old common law approach subsumed by the ***Vandergrift*** decision is no longer applicable (para 71):

> The purpose of the Supreme Court and the Court of Appeal of Alberta in *Dynex* [and *Dynex ABCA*] was to step away from the requirement that a royalty right had to have the incidents of a working interest or a *profit à prendre* in order to constitute an interest in land, so that royalty rights could play their useful role in financing the industry and spreading risk.

[43] In ***Dianor***, the agreements in question stated that the parties intended the gross overriding royalties to create interests in land that run with the lands, and that they were to be calculated on production as opposed to the value of the minerals *in situ* (at paras 26–27). Overruling the trial judge, the Court of Appeal held that "the fact that the GORs are calculated on production does not defeat the clear intention of the parties that the GORs constitute interests in land" (at para 77).

[44] I note also that if a GOR was defined as a reservation of the minerals or petroleum substances *in situ*, it "would necessarily detract from the title of the fee simple owner of the mines and minerals, and be tantamount to a grant of an undivided interest in the mines and

minerals, resulting in co-ownership" (***Canco*** at para 29). Defining a GOR as a share of the lessee's interest in the *in situ* minerals would essentially elevate the royalty holder's interest to a working interest, potentially exposing the royalty holder to a proportional share of abandonment costs and other environmental liabilities. These are precisely the kind of impracticalities that the ***Dynex ABCA*** and ***Dynex*** lineage of decisions have sought to avoid by holding that royalty interests need not be framed as an interest in the *in situ* minerals to constitute an interest in land.

(4) *Manitok Energy (Re)*

[45] ***Manitok Energy Inc (Re)***, 2018 ABKB 488 [***Manitok***] was the first decision of this Court following ***Dianor*** to consider whether a royalty constituted an interest in land based on the intention of the parties. ***Manitok*** involved a "Producing Royalty" granted "in respect of all Oil Volumes within, upon or under the Royalty Lands", but was calculated on volumes of oil produced at their point of sale (at para 8). The royalty holder was entitled to the first 140 barrels of oil produced per day from the subject lands for an initial period of 8 years, after which its interest would grind down by 10% per year relative to the prior (at para 10). Further, the royalty agreement explicitly stated that the "[Producing Royalty] 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" (at para 7).

[46] Relying on ***Dynex ABCA***, ***Dynex***, and ***Dianor***, Horner J held that neither the Producing Royalty's framing as "a fixed quantity of production per day", nor restrictions on the royalty holder's right of entry could defeat the characterization of the Producing Royalty as an interest in land so long as "the parties' intention to make it so is sufficiently clear" (at para 22). Similarly, the argument that the Producing Royalty should not be characterized as an interest in land because it decreased with time was rejected (at para 24). Horner J's decision on this point hinged on the fact that the decrease in the Producing Royalty was commensurate with reservoir depletion and the royalty agreement was drafted to preserve the Producing Royalty until the documents of title expired (at para 24). In other words, the Producing Royalty was capable of lasting for the duration of the underlying estate, satisfying the third indicia of an interest in land articulated in ***Dynex ABCA*** (see para [40]).

(5) *Accel Canada Holdings Limited (Re)*

[47] In ***Accel Canada Holdings Limited (Re)***, 2020 ABKB 182 [***Accel***], Horner J again had the occasion to consider whether multiple royalties constituted interests in land based on the intention of the parties to the royalty agreements (leave to appeal dismissed on the interest in land issue: 2020 ABCA 160).

[48] Accel entered into an Asset Purchase and Sale Agreement with ARC whereby Accel, as purchaser, granted ARC, as vendor, a gross overriding royalty in the underlying Petroleum and Natural Gas Rights as partial consideration for the transaction of those assets (the "ARC GOR"; at para 4). The ARC GOR would only crystallize if Accel defaulted on its obligation to pay a deferred purchase price plus interest by a specific date (at para 43). Upon triggering, the ARC GOR payments would grind down the outstanding amounts owed by Accel to ARC for six months, at which point ARC would provide Accel notice of the remaining balance and Accel would be given 10 days to pay the remaining balance in full (paras 43–47). If Accel did not pay the remaining balance within 10 days, the ARC GOR would continue in perpetuity (at para 47).

[49] Horner J opined that the ARC GOR could be interpreted as an interest in land "considering the potential for a royalty interest in perpetuity and plain wording of the provision stating that the ARC GOR creates an interest in land" (at para 41). Conversely, the ARC GOR could be construed as a contractual right to payment given that the Asset Purchase and Sale Agreement envisioned the ARC GOR "as a mechanism of ensuring payment and could be read to establish a contractual agreement to pay secured by a royalty interest" (at para 10).

[50] Given the ambiguity, Horner J considered ARC's post-contract conduct as an exception to the parol evidence rule to determine the issue. The most salient evidence was that ARC "registered a security agreement and a land charge at the Personal Property Registry…which identified ARC as the secured party, [Accel] as the Debtor and the collateral as all the Debtor's right, title, estate and interest in the Petroleum Substances produced from the Royalty Lands" (at para 61). The ***Personal Property Security Act***, RSA 2000, c P-7 ("*PPSA*") precludes the registration of interests in land [s 4(f)].

[51] Given (a) the tortuous waterfall of conditions that had to materialize for the ARC GOR to continue in perpetuity (*i.e.*, to last for the duration of the underlying estate) and (b) the surrounding circumstances, including ARC's post contract conduct consistent with the intention that the ARC GOR serve as security for payment of the deferred purchase price, Horner J found the parties intended the ARC GOR to be just that — a contractual right to security for payment, and not an interest in land (at para 63).

[52] To secure bridge financing for its capital requirements, Accel also entered into Royalty Purchase Agreements with BEST. Under those agreements, BEST provided financing and would obtain GORs as repayment if Accel didn't repay BEST the debt plus a return by a set date (at para 9). Neither repayment was met, so BEST assumed two GORs payable "until an Aggregate Proceeds Amount ("Payout") had been paid pursuant to the royalty payments due under the GOR Agreements" (the "BEST GORs"; at para 10). "Payout" was structured such that Accel was obligated to pay BEST the greater of either the purchase price of the BEST GOR plus $1M, or the purchase price of the BEST GOR plus "interest at a rate of 59.4% per annum calculated and compounded monthly" (at para 10).

[53] The fact that the BEST GORs created "limited reversionary interests that terminate upon repayment of the [debt]" weighed in favour of their characterization as security interests for the repayment of the proceeds of the financing arrangement as opposed to interests in land (at para 89–91).

(6) *Bacanora Minerals Ltd v Orr-Ewing*

[54] Despite this Court's endorsement of ***Dianor***'s clarification of the ***Dynex*** test and the ***Dynex ABCA*** approach to the intention-of-the-parties analysis in ***Manitok*** and ***Accel***, I am aware that the Court's recent decision in ***Bacanora Minerals Ltd v Orr-Ewing***, 2021 ABKB 670 [***Bacanora***] may appear to have resurrected the ***Vandergrift*** approach of searching for certain magic words that convey an intent to establish an interest in land.

[55] ***Bacanora*** dealt with a GOR carved from the grantor's lithium mining claims and pending mining claims in Mexico. The GOR was framed as a right to 3% of the revenue from the grantor's sale of raw or processed lithium-bearing ore extracted from the lands (paras 27–28). The agreement stated that the GOR "shall constitute a covenant running with the Assets" (*i.e.*, the mining claims) demonstrating that it was an interest capable of lasting for the duration of the

underlying estate (at para 29). The trial judge nevertheless held that the GOR created a contractual right to payment as opposed to an interest in land (at paras 79–80).

[56] In coming to this conclusion, the trial judge held that “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” (para 79). With great respect, this approach to the intention-of-the-parties analysis (*i.e.*, the ***Vandergrift*** approach) is no longer applicable based on the jurisprudence outlined above. The fact that a GOR is calculated on the value or revenue from minerals or petroleum substances severed from the land cannot defeat the otherwise clear intention of the parties that it constitute an interest in land.

[57] Further, the fact that a GOR doesn’t entail the royalty holder’s right to enter upon the lands and extract the resources themselves (*i.e.*, it doesn’t create a *profit à prendre*; see ***Bacanora*** at para 79), cannot alone preclude it from being an interest in land if the parties otherwise intended it so.

[58] This is not to say that the gross overriding royalty in ***Bacanora*** should be construed as an interest in land. That case arose in the context of a different extractive industry in another jurisdiction. I also note that McCarthy J stated, at para 81, that he “did not think that whether the underlying interest is in the land itself or is otherwise *in rem*, is determinative of the issue” before him and that he determined the issue “should it be deemed relevant upon appeal”. Given this, I simply hasten to say that the trial judge’s approach to interpreting whether the gross overriding royalty constituted an interest in land is not, in my view, reflective of the current state of the law and should not be read as reviving the ***Vandergrift*** approach that was disavowed by the Alberta Court of Appeal in ***Dynex ABCA***, the Ontario Court of Appeal in ***Dianor***, and by this Court in ***Manitok*** and ***Accel***.

2. Current state of the law

a) Examination of the parties’ intentions from the agreement as a whole and the surrounding circumstances

[59] As the Court of Appeal stated in ***Dynex ABCA***, the approach to examining the intention of the parties to establish an interest in land must consider “the agreement as a whole, along with the surrounding circumstances, as opposed to searching for some magic words” (at para 73, aff’d 2002 SCC 7; see also ***Dianor*** at para 63; ***Accel*** at para 16).

[60] The role of the reviewing court is to ascertain the interpretation of the royalty agreement that promotes or advances the true intention of the parties at the time of contracting. This must be done on an objective basis, focused on what a reasonable person would infer from the ordinary grammatical meaning of the terms of the agreement, “consistent with the surrounding circumstances known to the parties at the time of formation of the contract” (***Creston Moly Corp v Sattva Capital Corp***, 2014 SCC 53 at paras 47–49 [***Sattva***]; ***IFP Technologies (Canada) Inc v EnCana Midstream and Marketing***, 2017 ABCA 157 at para 79, leave to appeal to SCC refused 37712 (5 April 2018) [***IFP Technologies***]). “[T]he words of one provision must not be read in isolation but should be considered in harmony with the rest of the agreement and in light of its purposes and commercial context” (***Tercon Contractors Ltd v British Columbia (Minister of Transportation and Highways)***, 2010 SCC 4 at paras 64–65; ***IFP Technologies*** at paras 79, 81–84).

[61] With respect to the surrounding circumstances, courts must consider the facts that were known, or ought to have been known, by the parties at the time of contracting (***Sattva*** at paras 58, 60; ***IFP Technologies*** at para 83). This necessarily includes the genesis, aim, or purpose of the agreement; the nature of the relationship created by the agreement; and the nature or custom of the particular industry (***Sattva*** at para 48; ***IFP Technologies*** at para 83, ***Nexxtep Resources v Talisman Energy Inc***, 2013 ABCA 40 at para 33 [***Nexxtep Resources***]). By extension, courts must interpret royalty agreements according to sound commercial principles and business sense to avoid results that are unrealistic, absurd, or unreasonable with respect to the commercial realities of the industry (***IFP Technologies*** at para 88; ***Nexxtep Resources*** at para 35).

[62] Subjective evidence of the parties' intentions such as post-contract conduct is presumptively inadmissible (***IFP Technologies*** at para 87; ***Alberta Union of Provincial Employees v Alberta Health Services***, 2020 ABCA 4 at para 44; ***Accel*** at para 28). With respect to royalty agreements pertaining to freehold minerals, this includes the practice of registering a caveat with the land titles office or a security interest with the Personal Property Registry in relation to the royalty. Such post-contract conduct is only admissible where the words of an agreement "can be reasonably interpreted to have more than one meaning", resulting in ambiguity as to whether the parties intended for the royalty to be an interest in land (***Accel*** at para 28).

b) The core indicia of an interest in land

[63] Where 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 (an "Interest in Land Clause"), I find the foregoing jurisprudence suggests that such language 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 (***Canlin Resources Partnership v Husky Oil Operations Limited***, 2018 ABQB 24 at para 38, citing ***Ventas Inc v Sunrise Senior Living Real Estate Investment Trust***, 2007 ONCA 205 at para 24).

[64] A common thread since ***Dynex ABCA*** has been an emphasis on whether the royalty interest can last for the duration of the underlying estate (***Dynex ABCA*** at para 84; ***Manitok*** at para 24; ***Accel*** at para 51). If a royalty is drafted to extinguish before the underlying interest in land out of which the royalty was carved, it may rebut a presumption that the royalty itself is an interest in land. Conversely, if the royalty is drafted to run with the underlying interest in land in perpetuity, it will reinforce the nature of the royalty as an interest in land.

[65] Therefore, where the ***Dynex*** test distinguishes an interest in land from "a contractual right to a portion of the oil and gas substances recovered from the land", the distinction is between an interest in the produced resource that continues in perpetuity versus a contractual right to a portion of the produced resource as security for payment or performance of an obligation (see ***Accel*** at para 3). Whereas the former is capable of lasting for the duration of the underlying estate, a contractual right to security for payment or performance would extinguish upon repayment of the debt or performance of the obligation. This interpretation is supported by the policy reasons for upholding GORs as interests in land articulated in ***Dynex ABCA*** (at paras 35–36): a GOR that is capable of lasting for the duration of the underlying interest in land reflects an investment in "a particular piece of property", whereas a GOR designed to extinguish upon

repayment of a debt or performance of an obligation more closely reflects an investment in "a particular operator or company".

[66] The presence of an Interest in Land Clause in an agreement that creates a royalty capable of lasting for the duration of the underlying interest in land may be sufficient to satisfy the ***Dynex*** test. Whether or not ambiguity remains, the whole of the contract and the surrounding circumstances must nevertheless be considered to determine whether the parties intended the royalty to constitute an interest in land (***IFP Technologies*** at para 82). Still, courts cannot ignore the words chosen by the parties to a royalty agreement that clearly connote an intention to create an interest in land (***IFP Technologies*** at para 89; ***Hudson King v Lightstream Resources Ltd***, 2020 ABQB 149 at para 109). To rebut the presumption of an interest in land arising from the plain wording of a royalty agreement, the remaining indicia and the surrounding circumstances would have to significantly contradict the intention of the parties to create an interest in land and the ability of the royalty to last for the duration of the underlying estate.

B. Analysis

1. Whether the Crown Lease, out of which the 8% Royalty was carved, is an interest in land

[67] PrairieSky submits that the Crown Lease out which the 8% Royalty was carved is a working interest or a *profit à prendre* and, therefore, is unquestionably an interest in land capable of satisfying the second branch of the ***Dynex*** test. I agree (see ***Dianor*** at para 60; ***Orphan Well Association v Grant Thornton Ltd***, 2019 SCC 5 at para 11 [***Grant Thornton***]).

[68] Nevertheless, Yangarra argues that, because the rights conferred on PrairieSky through the Crown Lease are limited to the working interest in the minerals and do not entail ownership of the minerals *in situ*, PrairieSky was only able to grant an interest in the Crown Lease pursuant to the maxim "*nemo dat quad non habet*" — a seller cannot confer a greater title than that which they hold (the "*nemo dat*" principle). Respectfully, this misapprehends the nature of royalty interests, the *nemo dat* principle, and the second branch of the ***Dynex*** test.

[69] First, GORs such as the 8% Royalty granted under the 2011 Royalty Agreement are non-operating interests that do not entail an independent ownership interest in the land or the underlying lease (***Dynex ABCA*** at para 43; ***Dianor*** at paras 39, 72). GORs confer an unencumbered share or interest in the resources extracted from the lands pursuant to the underlying working interest (***Dynex*** at para 2; ***Dianor*** at para 34). Moreover, as the Ontario Court of Appeal aptly stated in ***Dianor***: "royalty rights-holders have no interest in working the land, nor do holders of the working interest or the *profit à prendre* want their operations to be subject to the working rights of a royalty rights-holder" (at para 72). The 2011 Royalty Agreement is no different — it does not purport to confer on the royalty holder an ownership interest in the *in situ* minerals or a working interest in the minerals equivalent to the lessee's interest. It confers an interest in the grantor lessee's entitlement to the substances produced from the land.

[70] Second, a GOR is not a "greater" interest than a leasehold or working interest in the *in situ* minerals, nor is it equal to a working interest. It is a distinct interest derived from a leasehold or working interest. Carving a GOR out of mineral lease does not offend the *nemo dat* principle, nor does that principle elevate a GOR to a working interest on par with the underlying leasehold interest. In the words of Laskin J in ***Saskatchewan Minerals***: "[i]n principle, a mining lessee

whose holding is an interest in land in respect of which he has a royalty obligation should be able to grant or submit to an overriding royalty in respect of that interest to take effect as itself an interest in the lessee's holding" (at 724–725, quoted approvingly in ***Dianor*** at para 76). Home Quarter, as lessee, had the right to convey a share in its own entitlement to the petroleum and natural gas recovered from the lands in accordance with the Crown Lease, and it did so when it granted Range Royalty the 8% Royalty. To find otherwise would undermine the useful role that GORs play in financing and spreading risk in upstream extractive industries.

[71] Having established that the Crown Lease is an interest in land satisfying the second branch of the ***Dynex*** test, the question is not whether Home Quarter had the capacity to grant an interest in land, but whether Home Quarter and Range Royalty *intended* the 8% Royalty carved out of the Crown Lease to be an interest in land.

[72] Finally, I reject Yangarra's argument that section 91(4) of the *MMA* applies to determine the effective date of the transfer of a Crown Lease. I agree with PrairieSky's argument in response that this provision does not govern the transfer of actual ownership of the working interest, but rather governs the transfer of the registered interest in a Crown Lease. Subsection 91(4) of the *MMA* provides that "[o]n the registration of a transfer, the transferee becomes the lessee with respect to the agreement, the undivided interest in the agreement or the part of the location so transferred". Importantly, lessee is defined in section 1 as "the holder according to the records of the Department of an agreement". Clearly, subsection 91(4) does not purport to determine the time at which ownership rights pass as between contracting parties. Those rights are determined by the contractual arrangements made by the contracting parties.

2. Whether the parties intended the 8% Royalty to constitute an interest in land

a) Interpreting the 2011 Royalty Agreement as a whole along with the surrounding circumstances

(1) The surrounding circumstances

[73] At trial, PrairieSky's witnesses gave evidence of the circumstances surrounding the formation of the 2011 Royalty Agreement. Mr. Lebbert (Range Royalty) and Mr. Purdy (Home Quarter) were experienced land professionals and vice presidents of their respective companies at the inception of the Land Fund Arrangement and the formation of the 2011 Royalty Agreement. As non-party witnesses, they were uniquely positioned to provide insight into the circumstances surrounding the formation of the 2011 Royalty Agreement. I found both witnesses were candid and credible and note that their evidence regarding the circumstances surrounding the 2011 Royalty Agreement was not challenged. As such, I accept their evidence, summarized below.

(a) The Home Quarter-Range Royalty Land Fund Arrangement

[74] Range Royalty was created in 2005 to invest in royalty interests and distribute the royalty income to it shareholders. Its limited partnership agreement prohibited Range Royalty from operating or investing in wells or facilities in order to avoid liability for abandonment and reclamation obligations. As a pure royalty company, ensuring that its royalty interests were construed as interests in land that ran with the subject lands and could not be extinguished through subsequent transactions, bankruptcies, or receivership proceedings was an important

consideration for Range Royalty. Accordingly, Range Royalty retained a lawyer to prepare a standard form royalty agreement with an "Interest in Land" clause.

[75] Home Quarter was initially set up by the principals of Range Royalty, including Mr. Lebbert, to operate a number of undeveloped Crown leases assigned to it by Range Royalty in exchange for a royalty. Thereafter, Range Royalty and Home Quarter put an undeveloped land fund arrangement in place whereby Range Royalty would fund the land acquisitions identified and secured by Home Quarter in exchange for a royalty (*i.e.*, the Land Fund Arrangement).

[76] Home Quarter's purchase of the Crown Lease from Trarion in 2011 was one such acquisition. Range Royalty elected to fund the acquisition of the Royalty Lands in exchange for the 8% Royalty and used the standard form royalty agreement its lawyer had drafted for all such transactions as the precedent for the 2011 Royalty Agreement. By design, there were no negotiations respecting the drafting of the 2011 Royalty Agreement beyond the royalty amount. Nevertheless, Home Quarter was well aware of the terms and nuances of the agreement as the standard form royalty agreement had been discussed and agreed to by Home Quarter and Range Royalty at the outset of the Land Fund Arrangement. Mr. Lebbert described this from Range Royalty's perspective in direct examination:

> Q Were there any negotiations between Home Quarter and Range Royalty with respect this royalty agreement?
> A No.
>
> Q Can you please turn to clause 9.5 which is on page 9?
> A Yes.
>
> Q It says 9.5 interest in land. What was your commercial understanding of this clause?
> A The purpose of this clause is - is to confirm that the royalty interest that was subject to the document was an interest in land running with the lands, and it was there forever.
>
> Q What do you mean it was there forever?
> A It was, long as the lands were in existence the royalty was against the lands. So, if -- royalties -- royalty pairs change hands regularly as companies swap assets, trade assets. Royalty owners tend to stay the same. So, it's just to make sure that the royalty was recognized, it's there. We - we were putting up money and - and again it was -- in those days through bankruptcy, some ba - some receivers were trying to - trying to wash caveat, wash royalty interests in bankruptcy, and we wanted to make sure that you couldn't do that.
> ...
>
> Q Was this clause 9.5 ever discussed with Home Quarter?
> A They -- it was discussed, this is our document, this is what we use.

[77] Mr. Purdy confirmed substantially the same from Home Quarter's perspective on direct examination:

> Q And you mentioned earlier that through the land fund arrangement, Range Royalty would receive a royalty. Up until the 2011 time frame, did you ever have any discussions with Range Royalty as to whether those royalties would constitute an interest in land or merely a contractual right?
> A Yeah, we had discussions via just the - the - the standard royalty agreement they gave us to review and attach to the land fund agreement. It had a specific interest in land clause within the royalty agreement that we reviewed and discussed with them.
>
> Q When did you review that and discuss it with Range Royalty?
> A Right at the start when Home Quarter was created in 2010.

[78] Mr. Purdy elaborated further on cross examination:

> Q And - and essentially, that [the 2011 Royalty Agreement] was the agreement that was provided by Range Royalty to Home Quarter. There wasn't an active negotiation regarding the agreement?
>
> A No - no negotiation but at the start of -- when we started Home Quarter and raised the original financings in 2010, we were given the opportunity to go through it in detail, and ask questions and - and -- yeah, we were comfortable with the - the format, but we were definitely able to ask questions and have discussions.

[79] Recognizing that the foregoing evidence may be construed as pre-contractual negotiations that would be inadmissible if presented as subjective evidence of the parties' intentions (see ***IFP Technologies*** at paras 84–85), it is worth reiterating that Mr. Lebbert and Mr. Purdy are non-party witnesses. As such, I find their evidence "is far more objective evidence of the parties' intentions than after-the-fact evidence from opposing parties about oral statements made during negotiations" (***IFP Technologies*** at para 85). Moreover, their discussion of the formation of the Land Fund Arrangement and the circumstances surrounding the 2011 Royalty Agreement was not contentious and is admissible evidence of the factual matrix that I am obligated to consider when interpreting the terms of the contract (***IFP Technologies*** at para 85).

(2) The granting clause

[80] Clause 2.1 of the 2011 Royalty Agreement (the "Granting Clause") reads:

> 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…[emphasis added]

[81] "Petroleum Substances" is defined in clauses 1.1 as "Crude Oil, Gas and Condensate". In turn, those substances are defined 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.

[82] "Reported Volumes" is defined as "those production volumes of Petroleum Substances…reported…from each wellhead on the Royalty Lands" (emphasis added).

[83] Yangarra submits that the Granting Clause and the foregoing definitions are indicative of a right to revenue from the working interest in the Crown Lease as opposed to an interest in land. While the granting clause uses terminology that has historically been associated with an interest in land ("within, upon, or under the Royalty Lands"), Yangarra notes that the grantee's interest is limited to a share of the volume of Petroleum Substances extracted from the land, as evidenced by the underlined words in the above clauses.

[84] Relying on ***Vandergrift***, ***St. Lawrence Petroleum***, and a strict reading of the first arm of the ***Dynex*** test (at para 22), Yangarra essentially argues that a "contractual right to a portion of the oil and gas substances recovered from the land" must be distinguished from an interest that runs with the land (emphasis added). As explained at paragraphs [64]–[65], the purpose of the first arm of the ***Dynex*** test is to distinguish an interest in the produced resource that continues in perpetuity (an interest in land) from a contractual right to the produced resource as security for payment or performance of an obligation. I do not find the fact that the 8% Royalty is framed as an interest in the Petroleum Substances produced from the Royalty Lands relevant to the intention of the parties to create an interest in land (***Canco*** at paras 29–30).

[85] Yangarra's position also betrays an assumption that only an interest in the minerals or petroleum substances *in situ* can be said to run with the land. Yet, as Yangarra points out in its related *nemo dat* argument, the Crown maintains ownership of the minerals *in situ* and, as a result, lessees of Crown minerals can't convey an interest in the ownership of the minerals *in situ*. If Yangarra's implied assumption were true, no royalty carved out of a lease of mineral rights would ever be capable of being an interest in land without the express consent of the fee simple owner of the mines and minerals. This would significantly frustrate the useful role that royalties play in upstream extractive industries.

[86] Further, the assumption that only an interest in the *in situ* minerals or petroleum substances can be an interest in land effectively seeks to restore the prohibition on the creation of an interest in land from an incorporeal hereditament. Respectfully, that is not the law nor the practice of the oil and gas industry. Yangarra's position embraces precisely the type of anachronisms the Alberta Court of Appeal in ***Dynex ABCA*** and the Supreme Court in ***Dynex*** sought to do away with (see also ***Dianor*** at para 71).

[87] The ***Dynex*** test is predicated on an understanding of the important role that royalties play in extractive industries, which would be undermined if GORs were not capable of running with the land unless they entailed an interest in the *in situ* resource. Whether 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.

[88] The Granting Clause does not merely articulate an undertaking to pay the royalty holder a portion of the Produced Substances or proceeds from the sale thereof. The words "granted to" and "owned by" connote the conveyance of ownership in respect of the 8% Royalty as opposed to a mere contractual right to a portion of the Produced Substances as security for payment of a debt or performance of a service (***Bensette v Reece***, 1969 CanLII 550 (SKQB) at para 21, (1969) 7 WWR 705, rev'd on other grounds CanLII 975 (SKCA), [1973] 2 WWR 497; ***Scurry-Rainbow*** at para 102; ***Blue Note Mining Inc v Merlin Group Securities Ltd***, 2008 NBQB 310 at para 40, aff'd 2009 NBCA 17; ***St. Andrew Goldfields*** at paras 101–102). I find those words support the inference that the parties intended the 8% Royalty to be a proprietary interest in land.

(3) The "Interest in Land" clause

[89] Clause 9.5 (the "Interest in Land Clause) of the 2011 Royalty Agreement reads as follows:

> 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. [emphasis added]

[90] As previously noted at paragraph [4], s 202(a) of the *LTA* prohibits the registration of caveats or other encumbrances affecting Crown-owned minerals, rendering the underlined portion of the Interest in Land clause moot. Yangarra submits that the inclusion of such language that is incongruent with the 8% Royalty undermines the surrounding plain words that otherwise demonstrate an intention to establish an interest in land. Both Mr. Lebbert and Mr. Purdy testified that to, to their knowledge, one could not register an encumbrance on Crown Lands. Mr. Lebbert in particular testified that Range Royalty did not register or caveat the 2011 Royalty Agreement because it was his understanding that this was not possible. Given that both Mr. Lebbert and Mr. Purdy knew at the time of contracting that it was not possible to register a caveat affecting Crown-owned minerals in Alberta, Yangarra submits that the inclusion of the underlined portion indicates Range Royalty and Home Quarter never turned their minds to clause 9.5 and whether the 2011 Royalty Agreement operated to create an interest in land.

[91] Yet, Mr. Lebbert testified that the Interest in Land Clause was included in the 2011 Royalty Agreement "to confirm that the royalty interest that was subject to the document was an interest in land running with the lands, and it was there forever." PrairieSky submits that Mr. Lebbert's and Mr. Purdy's testimony that they reviewed and discussed clause 9.5 in the context of the standard form agreement used for the 2011 Royalty Agreement suggests they clearly turned their minds to whether the 8% Royalty would constitute an interest in land. PrairieSky further submits that the remainder of clause 9.5 sufficiently demonstrates the parties' intention that the 8% Royalty constitute an interest in land. I agree with PrairieSky.

[92] I accept the testimony of Mr. Lebbert and Mr. Purdy that Range Royalty and Home Quarter used a standard form royalty agreement to execute transactions pursuant to their Land

Fund Arrangement, and that they did so to ensure certainty and consistency of the terms of the royalties created, regardless of the type of land subject to each royalty agreement. I find that the retention of the underlined portion of clause 9.5 in the 2011 Royalty Agreement reflects the use of the standard form agreement. I find that its inclusion does not detract from the otherwise plain wording of clause 9.5 that clearly suggests the parties intended the 8% Royalty to constitute an interest in land.

[93] Moreover, the language of the underlined portion of clause 9.5 is permissive; it does not impose on the royalty holder an obligation to register the 8% Royalty such that it would be rendered unenforceable. It merely implies that the royalty holder *may* do so. The fact that the royalty holder cannot do so in the circumstances does not detract from the surrounding portions of the Interest in Land Clause: "[t]he Overriding Royalty constitutes an interest in land, shall be regarded as covenants running with the Royalty Lands ... and enforceable against Grantor and any successors in interest to Grantor".

[94] I find that clause 9.5 strongly conveys the parties' intention that the 8% Royalty constitutes an interest in land that runs with the underlying Lands and is enforceable against Home Quarter's successors in interest to the Crown Lease.

(4) The "Term", "Surrender", and "Area of Mutual Interest" clauses

[95] Clause 9.6 of the 2011 Royalty Agreement (the "Term Clause") provides as follows:

> 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".

[96] "Working Interest" is defined as "the working interests held by Grantor in respect of the Royalty Lands as set out and described in Schedule "A", and Schedule "A" describes the Crown Lease. Accordingly, the Term Clause specifies that the 8% Royalty is to last for the duration of the underlying Crown Lease, regardless of whether the Crown Lease is assigned to a third party. This further evidences an intention to create an interest in land that runs with the underlying estate in land (***Dynex ABCA*** at para 84).

[97] The Surrender clause (clause 9.1) and definition of "Title Documents" referenced thereunder stipulate that the grantor may only surrender the Crown Lease in accordance with "accepted industry practice" and must first offer to convey its interest in the Crown Lease to the royalty holder before surrendering. By extension, the grantor cannot allow the 8% Royalty to extinguish by surrendering or otherwise allowing the underlying Crown Lease to expire by failing to meet the continuation obligations required under the applicable regulations except in accordance with sound industry practices.

[98] Initially granted in 1979, the Crown Lease had been continued indefinitely beyond the primary and intermediate terms by the time Home Quarter became lessee. Therefore, when the 2011 Royalty Agreement was executed, the Crown Lease or portions thereof would only expire and revert to the Crown if the lessee could no longer demonstrate that the subject geologic zones were productive or potentially productive, and that they were not being drilled at the time of expiry (***Petroleum and Natural Gas Tenure Regulation***, Alta Reg 263/1997 ss 15–18). The

Surrender clause therefore implies that the 8% Royalty is capable of lasting for the duration of the productive life of the reservoirs subject to the Crown Lease.

[99] Finally, the Area of Mutual Interest clause (clause 8.1) stipulates that, if the Royalty Lands subject to the Crown Lease revert back to the Crown by expiry or surrender but are reacquired by the grantor within two years, the 8% Royalty shall apply to those lands reacquired by the grantor. Considering the Term and Surrender clauses alongside the Area of Mutual Interest clause, I find the 8% Royalty was an investment in the success of "a particular piece of property" (***Dynex ABCA*** at para 36), as opposed to an extinguishable mechanism for the repayment of a debt. This further reinforces the parties' intention that the 8% Royalty constitute an interest in land.

(5) The "Taking in Kind" clause

[100] Clause 2.2 of the 2011 Royalty Agreement articulates the royalty holder's "right to take in kind or separately dispose of, at its own expense, its [8% Royalty] share of the Petroleum Substances." This Court has previously held that right of royalty holders to take their royalty in kind reflects a right of personal ownership that is indicative of an interest in land (***Bank of Montreal v Dynex Petroleum Ltd***, 2003 ABQB 243 at para 40; ***James H Meek Trust v San Juan Resources Inc***, 2003 ABQB 1053; ***Accel*** at para 50). Yangarra submits that, while provisions allowing for royalty holders to "take in kind" the substances extracted from the land may weigh toward a GOR being characterized as an interest in land, they do not, in and of themselves, create an interest in land. I agree.

[101] With regards to the important role that royalties play in attracting capital for upstream oil and gas ventures, for example, certain investors may lack the operational capacity to physically take possession of and market oil, gas, or condensate, rendering a "take in kind" provision in a royalty agreement potentially irrelevant to them. The parties' intention to establish an interest in land therefore should not be dependent on the royalty holder's ability to take the royalty payment in kind. Nor should emphasis be placed on take-in-kind provisions as indicia of interests in land to the extent they demonstrate the royalty holder's measure of control over the interest. Such a control-oriented approach incorrectly seeks "to turn the royalty owner's passive [non-operating] interest into a working interest" (***Dianor*** at para 73, quoting Nigel D Bankes, "Private Royalty Issues: A Canadian Viewpoint" (2003) Private Oil & Gas Royalties, Paper No. 8, Rocky Mountain Mineral Law Foundation at 195).

[102] Moreover, a take-in-kind provision could be equally applicable as a contractual right to take the produced substances in kind as security for the payment of a debt, which would not reflect an interest in land. Absent additional context as to how take-in-kind provisions evidence the intention that the subject GOR constitute an interest in land, I find that the mere presence of such clauses does not illuminate the parties' intention. Accordingly, I find the Taking in Kind clause of the 2011 Royalty Agreement neutral with respect to whether the parties intended the 8% Royalty to constitute an interest in land.

(6) The "Pooling" and "Unitization" clauses

[103] Clause 4.1 of the 2011 Royalty Agreement (the "Pooling Clause") stipulates that the grantor has the discretion to "pool all or a part of the Royalty Lands with any other lands for the purposes of creating a Spacing Unit if such pooling becomes necessary or desirable in the opinion of the Grantor." Pooling refers to the amalgamation of contiguous tracts of land subject

to different ownership within an area of common drainage known as a drilling spacing unit. Pooling enables the drilling of one well within the drilling spacing unit to preserve optimal reservoir conditions and prevent the drainage of one tract of land by a different working interest-holder. In the event the Royalty Lands are pooled, the Pooling Clause provides for the payment of the 8% Royalty "on the basis of production deemed to be produced from or allocated to the Royalty Lands on an acreage basis".

[104] Conversely, clause 4.2 of the 2011 Royalty Agreement (the "Unitization Clause") stipulates that the grantor must obtain the royalty holder's written consent "to unitize all or a part of the Royalty Lands with any other lands if such unitization becomes necessary or desirable in the opinion of the Grantor." Such consent must not be unreasonably withheld. Unitization refers to the amalgamation of tracts of land subject to different ownership *between* drilling spacing units. The Unitization Clause similarly provides for the payment of the 8% Royalty "on the basis of production deemed to be produced from or allocated to the Royalty Lands under the plan of unitization". The policy concerns underlying the need for pooling and unitization include resource conservation, the fair allocation of the resource to the appropriate owners, and the avoidance of unnecessary drilling (***Oil and Gas Conservation Act***, RSA 2000, c O-6 s 4).

[105] Relying on ***Accel*** (at para 89), Yangarra submits that the absence of a clause requiring the royalty holder's consent for the grantor to pool the subject lands is indicative of an interest that does not run with the lands. I disagree. First, while the Pooling Clause indicates the grantor is entitled to pool the lands without the express consent of the royalty holder, the subsequent clause — the Unitization Clause — conspicuously provides for the exact opposite. If the royalty grantor's discretion with respect to such operational decisions were indicative of whether the 8% Royalty constitutes an interest in land, the effects of the Pooling and Unitization clauses would negate each other.

[106] Second, as with take-in-kind clauses, placing too heavy an emphasis on the grantor's discretion — or lack thereof — regarding operational decisions such as pooling and unitization incorrectly seeks to equate passive, non-operating royalty interests with working interests. As the ***Dianor*** Court helpfully explained at para 71, the purpose of the ***Dynex ABCA*** and ***Dynex*** decisions "was to step away from the requirement that a royalty right had to have the incidents of a working interest ... in order to constitute an interest in land, so that royalty rights could play their useful role in financing the industry and spreading risk."

[107] Finally, if a grantor were at all times required to obtain the consent of the royalty holder to pool or unitize the lands for a GOR to constitute an interest in land, the ability of the grantor to operate in a manner that upholds conservation and environmental principles may be frustrated. While clauses that require the express consent of the royalty holder for the grantor to pool the lands within a drilling spacing unit may be overridden by a compulsory pooling order [*OGCA* s 80(3)], the Alberta Energy Regulator presently lacks jurisdiction to compel unitization beyond a drilling spacing unit, even if it would promote conservation and environmental principles. Yangarra's implied suggestion that the consent of royalty holders for pooling and unitization should be required for GORs to constitute interests in land raises the spectre of investor holdouts on such consent. This risks unnecessarily restricting the pool of investors that operators would be willing to enter into royalty agreements with.

[108] For these reasons, I find the Pooling and Unitization clauses of the 2011 Royalty Agreement neutral with respect to whether the parties intended the 8% Royalty to constitute an interest in land.

(7) The "Assignment" clause

[109] Clause 3.1 (the "Assignment Clause") incorporates the 1993 Canadian Association of Petroleum Landmen Assignment Procedure (the "CAPL Assignment Procedure") and the related "Notice of Assignment" form by reference under the 2011 Royalty Agreement. The Assignment Clause reads as follows:

> The 1993 CAPL Assignment Procedure and the Notice of Assignment form are incorporated by reference hereto and are deemed to apply as if it had been included as a Schedule to this Agreement, with respect to any assignment of any interest in this Agreement. Notwithstanding the foregoing, Grantor shall not be entitled to assign any interest in this Agreement if Grantor is default of any provision hereof.

[110] Mr. Lebbert explained that the CAPL Assignment Procedure is incorporated into industry agreements as a means of dispensing with the need to execute assignment and novation agreements every time an interest in an oil and gas agreement or royalty agreement is transferred to a new party. Instead, by incorporating the CAPL Assignment Procedure, the streamlined Notice of Assignment form is used.

[111] Yangarra argues that the incorporation of the CAPL Assignment Procedure and Notice of Assignment form under the 2011 Royalty Agreement indicates the parties did not intend for the 8% Royalty to constitute an interest in land for the following reasons:

1. if the 8% Royalty runs with the Royalty Lands, it would always bind the working interest holder of the Crown Lease, rendering a mechanism for the assignment of the 2011 Royalty Agreement to the new owner unnecessary; and

2. if the 8% Royalty runs with the Royalty Lands, it would always bind the working interest holder of the Crown Lease, but the CAPL Assignment Procedure would create a conflicting situation in the event the royalty holder objected to the assignment of the 2011 Royalty Agreement because the new lessee's interest would be free and clear of the 8% Royalty.

[112] With respect to Yangarra's first argument, the Assignment Clause applies to "any assignment of any interest" in the 2011 Royalty Agreement. The CAPL Assignment Procedure therefore applies equally to the royalty holder's interest in the 2011 Royalty Agreement as it does to the interest of the grantor and its successors. If the CAPL Assignment Procedure were indeed unnecessary for the 8% Royalty to continue to run with the Royalty Lands, it would nevertheless be relevant to the assignment of the royalty holder's interest in the 2011 Royalty Agreement.

[113] In rebuttal to Yangarra's first argument, PrairieSky asserts that it was common for oil and gas participants to execute assignment and novation agreements in respect of royalties carved out of Crown leases, including when the royalty constituted an interest in land. PrairieSky points to the fact that, since 1979 — when the 2% GOR was carved out of the Crown Lease — each time

the Crown Lease was transferred to a new lessee, including when Yangarra acquired the Crown Lease, the 2% GOR was assigned to the new lessee by way of an assignment and novation agreement. The 1979 Royalty Agreement provides that, if the Crown Lease is assigned, the former lessee is still obligated to pay the 2% GOR until the royalty holder is provided with a written undertaking by the new lessee to perform and be bound by the terms of the 1979 Royalty Agreement.

[114] Mr. Faminow testified that he was satisfied the 2% GOR was an interest in land upon reviewing the 1979 Royalty Agreement, and that Yangarra would be responsible for paying the 2% GOR upon purchasing the Crown Lease. Accordingly, he advised Relentless that an assignment and novation agreement with respect to the 1979 Royalty Agreement would be required as part of its purchase of the Crown Lease. PrairieSky submits that this further reinforces the common industry practice of executing assignment and novation agreements to perfect the transfer of the payor’s interest in royalty agreements along with the transfer of the underlying lease.

[115] The Assignment Clause must be interpreted considering the nature and custom of the industry (***IFP Technologies*** at para 83; ***Nexxtep Resources*** at para 33). Therefore, I agree with PrairieSky 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.

[116] Further, I do not find that a royalty holder’s objection to the assignment of the 2011 Royalty Agreement pursuant to the CAPL Assignment Procedure necessarily conflicts with the 8% Royalty running with the Crown Lease. First, clause 2.04 of the CAPL Assignment Procedure stipulates that consent to assignment cannot be unreasonably withheld. The purported conflict would thus only arise in the circumstance that consent is *reasonably* withheld.

[117] Second, and more to the point, the 8% Royalty would not simply extinguish upon the transfer of the Crown Lease to a new lessee in the face of the reasonable objection of the royalty holder to the assignment of the 2011 Royalty Agreement. If it is indeed an interest in land, the 8% Royalty would continue to encumber the Crown Lease, and the royalty holder would still be entitled to payment of the 8% Royalty. In the case of an assignment to a third party without that party being novated into the 2011 Royalty Agreement, the royalty holder would be entitled to continue to look to the previous working interest-holder for payment of the 8% Royalty pursuant to the common law of assignment in the absence of novation (***National Trust Co v Mead***, [1990] 2 SCR 410 at 426–427, 1990 CanLII 73 (SCC); ***St. Andrew Goldfields*** at paras 109-111).

[118] I do not find the fact that the payment obligation would remain with the previous working interest-holder bears on the parties’ intention as to whether the 8% Royalty constitutes an interest in land. It simply provides the royalty holder with the option to reasonably withhold consent to an assignment that would transfer the payment obligations to the new owner, if, for example, the third party had any concerns about the new owner’s ability to pay the 8% Royalty.

[119] Accordingly, I find the Assignment Clause and the CAPL Assignment Procedure incorporated thereunder neutral with respect to the parties’ intention that the 8% Royalty constitute an interest in land.

b) Conclusion as to the parties' intention to create an interest in land

[120] I am satisfied that Range Royalty and Home Quarter intended for the 8% Royalty to constitute an interest in land that runs with and binds the Royalty Lands subject to the Crown Lease. I find so based on the plain language of the Interest in Land Clause and because the remainder of the 2011 Royalty Agreement reviewed above is drafted to ensure that the 8% Royalty will last for the duration of the underlying Crown Lease. Moreover, the factual matrix surrounding the formation of the 2011 Royalty Agreement demonstrates that the 8% Royalty was one of a series of royalties created by the parties pursuant to the Land Fund Arrangement. The Land Fund Arrangement was predicated on the parties' mutual understanding that the royalties they created would constitute interests in land, and the 8% Royalty under the 2011 Royalty Agreement reflects that understanding.

V. Issue 2: Does the 8% Royalty have priority over Yangarra's interest in the Crown Lease?

[121] Although the 8% Royalty constitutes an interest in land capable of running with the Crown Lease for the duration of the latter's existence, Yangarra asserts that it is a BPFV and should not be bound by the 8% Royalty pursuant to the law of equity.

[122] The Torrens system of land registration and transfers enables the determination of the priority of interests regarding the lands in question pursuant to the *LTA*. With some exceptions, the *LTA* provides that a purchaser is not bound by any prior unregistered interests or claims, essentially codifying the principle of BFPV to defeat all unregistered interests (ss 60–61, 203; see *e.g.*, ***Bretin v Ross***, 2019 ABQB 957 at para 29; ***Novia Development Ltd v Caleron Properties Ltd***, 2016 ABQB 406 at para 136). As previously noted at paragraph [4], however, the Torrens system does not apply here because a) certificates of title are generally not issued for unpatented Crown lands (see ***Molner v Stanolind Oil & Gas Co et al***, 1959 CanLII 73 (SCC), [1959] SCR 592 at 594) and have not been issued for the Crown Lands here; b) section 134(2) of the *LTA* prohibits the registration of caveats against lands for which a certificate of title has not been issued; and c) subsection 202(a) of the *LTA* prohibits the registration of interests against Crown-owned minerals.

[123] Yangarra nonetheless submits that section 91 of the *MMA* "creates a statutory scheme by which all interests in land derived under a Crown Lease are capable of being registered in the [Province's electronic transfer system ("ETS")]." As explained by Mr. Truscott, the Province of Alberta maintains the ETS, within which transfers of Crown lease agreements may be registered pursuant to section 91 of the *MMA*.

[124] Section 91(1) of the *MMA* provides as follows:

> A transfer with respect to an agreement that the lessee is not prohibited from transferring or agreeing to transfer by any provision of this Act or any regulation or by the terms of the agreement, may be registered by the Minister if the regulations respecting registration of the transfer are complied with and if the transfer conveys
>
> (a) the whole of the agreement
>
> (b) a specified undivided interest in the agreement, or

(c) a part of the location contained in the agreement

Further, section 91(5) of the *MMA* stipulates that, if the transfer of an interest under section 91(1) is not registered in the ETS, then any registered transfer is valid against, and prior to, the unregistered transfer.

[125] An "agreement" referenced in section 91 of the *MMA* is defined as "an instrument issued pursuant to this Act or the former Act that grants rights in respect of a mineral" [*MMA* s 1(1)(a)]. An "agreement" unquestionably includes Crown Petroleum and Natural Gas Leases such as the Crown Lease in question (***Alberta Energy Company Ltd v Goodwell Petroleum Corporation Ltd***, 2003 ABCA 277 at para 89). A "specified undivided interest in the agreement" under section 91(1)(b) therefore refers to a specified undivided interest in a Crown Petroleum and Natural Gas Lease. It does not refer to non-operating, passive interests in Crown leases, such as GORs. Support for this is found in the fact that the Memorandums of Registration and Records of Registration attached to the original copy of the Crown Lease exclusively reference transfers of either a 50% or 100% "undivided interest" in the "agreement" itself — they do not reference the 2% GOR or the 8% Royalty, notwithstanding the fact that those encumbrances run with the Crown Lease and were upheld by the lessees prior to Yangarra. Further, I accept the evidence presented at trial that that a search of the ETS does not reveal encumbrances attached to the Crown Lease.

[126] Yangarra's argument that section 91 of the *MMA* provides a complete scheme for the registration of the 8% Royalty must fail as it once again conflates a passive royalty interest with a working interest. Yangarra initially suggested that, because the 8% Royalty does not entail the incidents of a working interest, it does not constitute an interest in land (see paragraphs [68]–[70]). Yet here, Yangarra insinuates the 8% Royalty *is* a working interest by asserting it is an "undivided interest" in the Crown Lease under section 91(1)(b) of the *MMA*, which itself is a working interest (see paragraph [67]). For substantially the same reasons described at paragraphs [44] and [69]–[70], the 8% Royalty does not entail an undivided interest in the Crown Lease or — in other words — a working interest in the mines and minerals.

[127] The ETS only provides for the registration of security notices in respect of a security interest pursuant to section 95 of the *MMA*. A "security interest" is defined in section 94(1)(e) of the *MMA* as "an interest in or charge on collateral" that secures payment of a debt, bonds or debentures of a corporation, or the performance of an obligation." As determined under Issue 1, the 8% Royalty is not a contractual right to security for payment or performance of an obligation — it is an interest in land. Therefore, section 95 of the *MMA* does not provide for the registration of the 8% Royalty. Based on the same characterization, the 8% Royalty is also not qualified for registration with the Personal Property Registry [*PPSA* ss 1(1)(tt), 4(f)]. Moreover, each of Mr. Truscott, Mr. Reimer, Mr. Purdy, Mr. MacDonald, and Mr. Percy testified that a royalty cannot be registered in respect of a Crown mineral lease on the ETS or Personal Property Registry.

[128] Contrary to Yangarra's assertions, there were no public registries where Range Royalty and its successors could have registered notice of the 8% Royalty against the Crown Lands. Where, as here, the applicable land registration legislation does not apply, priority must be determined by the rules of priority of competing interests at common law and in equity (Thackray at § 7.75; AH Oosterhoff and WB Rayner, *Anger and Honsberger Law of Real Property*, 2d ed, vol 2 (Aurora: Canada Law Book Inc, 1985) at 1591 at 1592 [Oosterhoff and Rayner]). These first principles vary depending on whether the competing interests are legal or

equitable in nature. It is therefore necessary to characterize the interests held by PrairieSky and Yangarra to determine their priority and whether the equitable principle of BFPV applies.

A. Are the parties' interests legal or equitable?

[129] Four basic permutations can arise from the characterization of competing interests as legal or equitable: (i) there are two legal interests; (ii) there are two equitable interests; (iii) there is a legal interest followed by an equitable interest; and (iv) there is an equitable interest followed by a legal interest (Bruce Ziff, *Principles of Property Law*, 5th ed (Toronto: Carswell, 2000) at 460 [Ziff]).

[130] There are two main distinctions between legal and equitable interests in the context of interests in land:

1. whereas legal interests are rights "*in rem*", which permanently bind the lands over which they are exercisable and may be enforced against the land (***Wiebe v Enns***, 1971 CarswellMan 28 [1971] 3 WWR 469 at para 14); equitable rights are "*in personam*", and may only be enforced against certain persons (Rt Hon Sir Robert Megarry, *A Manual of the Law of Real Property*, 8th ed (London: Sweet and Maxwell Limited, 2002) at 58 [Megarry]); and

2. a legal interest must be created or transferred in the manner prescribed either by the common law or by statute; an equitable interest, on the other hand, may be created or transferred informally, without perfecting the interest pursuant to the requirements of common law or statute (Megarry at 68).

[131] I now turn to characterizing the competing interests of PrairieSky and Yangarra.

1. The 8% Royalty

[132] The Court of Appeal recently defined an "interest in land" in the context of differentiating legal and equitable interests under the *LTA* and the *Law of Property Act*, RSA 2000, c L-7 in ***Morrison v Moe-villa Investments Ltd***, 2022 ABCA 159 at para 26 [***Morrison***]:

> The requirement of an "interest" in land means a legally recognized proprietary interest in that land, not a mere claim, contractual right or expectation with respect to that land. For example, an assignment of rents or a right of first refusal to purchase land create personal contractual rights, not "interests in land" that would support a caveat: ***Canada Trustco Mortgage Company v Skoretz* (1983)**, 1983 CanLII 1058 (AB QB), 26 Alta LR (2d) 60, 45 AR 18 [***Canada Trustco***], which was approved in ***Northland Bank v Van de Geer***, 1986 ABCA 252, 49 Alta LR (2d) 113, 75 AR 201. For that reason, rights of first refusal and assignments of rents had to be deemed by statute to be equitable interests in land: *Law of Property Act*, RSA 2000, c L-7, s. 63.

[133] 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.

[134] Further, Range Royalty and Home Quarter complied with all formal common law requirements for a valid conveyance of an interest in land when they entered into the 2011 Royalty Agreement: there was an offer, acceptance, consideration, and a written agreement signed by the parties (***Statute of Frauds* 1677**, (29 Car 2) c 3 s 4; ***1353141 Alberta Ltd v Roswell Group Inc***, 2019 ABQB 559 at para 205, citing ***Austie v Aksnowicz***, 1999 ABCA 56 at para 23). Home Quarter and Range Royalty accepted the terms of the 2011 Royalty Agreement and signed it. The consideration for the agreement consisted of Range Royalty reimbursing Home Quarter for its purchase of Trarion's interest in the Crown Lease, which consideration was paid by Range Royalty and received by Home Quarter.

[135] Relying on ***Canada Trustco*** at para 17, Yangarra nonetheless argues that PrairieSky's 8% Royalty is an equitable interest because it is a contingent or future contractual right or expectation with respect to the Crown Lands. The discussion in ***Canada Trustco*** concerned the 19th century English case of ***London & South Western Ry Co v Gomm***, (1882) 20 Ch D 562, [1882] 3 WLUK 13, in which the vendor agreed to sell the purchaser certain lands on the condition that the purchaser would be obligated to reconvey the land to the vendor upon the vendor's request. The purchaser sold the land to a third party who then refused to convey the land back to the original vendor when the condition in the original agreement was called (***Canada Trustco*** at para 17). The Court of Appeal held that "[t]he right to call for a conveyance of the land is an equitable interest".

[136] Range Royalty's interest in the form of the 8% Royalty was not, however, contingent on a future event such as a request for reconveyance, a mortgager's default in the case of an assignment of rents, or a proposed sale triggering a right of first refusal. The 8% Royalty crystallized as soon as the parties closed the transaction under the 2011 Royalty Agreement. The fact that payment of the 8% Royalty only occurred when Petroleum Substances were produced from the Royalty Lands does not mean that such production was a condition precedent to the 8% Royalty vesting as an interest in land. If that were the case, it would entail tremendous risk for investor royalty holders as GORs would simply extinguish if the grantor lessee failed to establish production before transferring the lease to a third party.

[137] Even if the 8% Royalty were merely an equitable interest contingent on future production at the time the 2011 Royalty Agreement was executed, it would have crystallized as a legal interest as soon as Petroleum Substances were produced from the Royalty Lands upon Home Quarter becoming the operator. Production data in evidence shows the 102/04-07-041-05W5 well flowed oil in June and July of 2011. Yangarra's argument therefore has no merit. The 8% Royalty is a legal interest in land.

2. Yangarra's interest in the Crown Lease

[138] As previously discussed, the Crown Lease grants to the lessee a working interest in the petroleum and natural gas. A working interest is a proprietary, *in rem* right in land (***IFP Technologies***, at para 98; ***Dianor*** at para 34; ***Grant Thornton*** at para 11; Tom Cumming, Caireen E Hanert, Jeff Oliver, "The Intersection of Regulatory and Insolvency Law: Redwater's Final Chapter and the Aftermath" in Janis P Sarra, ed, *Annual Review of Regulatory and Insolvency Law 2019* (Toronto: Thomson Carswell, 2020) 127). The Crown Lease therefore conveys a legal interest.

[139] As the current lessee, Yangarra holds the rights and interests provided under the Crown Lease, which it acquired through a purchase and sale agreement with Relentless ("PSA").

However, PrairieSky submits that Yangarra did not acquire a legal interest in the Crown Lease, because Yangarra and Relentless did not comply with the formal requirements of closing under the PSA. Specifically, PrairieSky asserts that closing never occurred because Yangarra never paid Relentless the nominal purchase price of $1.00 prescribed under the PSA.

[140] The PSA incorporated the CAPL Transfer Procedure, which defines “Closing” as “the delivery of those documents and amounts described in Clause 3.03” (“Closing”). Clause 3.03 stipulates that Yangarra was to deliver to Relentless “payment of any amount owing at Closing under the Agreement”, which included the “Purchase Price”, defined as “cash consideration of One Dollar CDN ($1.00 CDN)”. To waive payment of the Purchase Price pursuant to the CAPL Transfer Procedure, Relentless would have had to deliver written notice advising Yangarra of as much. It is not disputed that Yangarra never paid Relentless the $1.00 and Relentless never waived the payment pursuant to the CAPL Transfer Procedure.

[141] As stated by Germain J of this Court in ***641224 Alberta Ltd v 610042 Alberta Ltd***, 2005 ABQB 606 at para 80 [***641224***], “[l]awyers have, for the last 200 years, attempted to make contracts in which there is an exchange of promises, more binding by throwing in nominal consideration.” Since the foundational Supreme Court decision of ***Davidson v Norstrant* (1921)**, 1921 CanLII 26 (SCC), 61 SCR 493 [***Davidson***], courts have been reluctant to find that the failure to pay such nominal or “paltry” consideration invalidates or renders a contract unenforceable when the parties did not intend for the payment to actually be a condition precedent to the transaction closing (***Kazakoff v Milosz***, 1977 CanLII 2709 (AB QB), [1977] AJ No 586 (QL) at para 24; ***641224*** at paras 86–89; ***Southam Inc v Newton Industrial Plaza Ltd***, 1992 CanLII 2197 (BC SC) at 5–7, 1992 CarswellBC 670; ***5240 Investments Ltd v Great Eagle Resources Ltd***, 2013 BCSC 35 at para 105 [***Great Eagle Resources***]). What emerges from the cases is that nominal consideration is waivable where the parties did not intend for payment of the nominal consideration to be a condition precedent to closing given that “the contract’s substantive consideration lies in the benefits each party derived from its terms” (***Great Eagle Resources*** at para 112).

[142] As a threshold matter, I note that Relentless is not seeking to repudiate the PSA with Yangarra in these proceedings based on the nonpayment of the nominal $1.00 purchase price. In fact, Relentless is not even a party to these proceedings and it would be inappropriate to impute Relentless’ subjective intentions regarding the PSA based on the submissions of a third party. Privity of contract also generally precludes the enforcement of the terms of a contract by third parties, which PrairieSky attempts to do here in seeking to enforce a strict reading of the provisions of the Relentless-Yangarra PSA (***London Drugs Ltd v Kuehne & Nagel International Ltd***, [1992] 3 SCR 299 at 416, 1992 CanLII 41 (SCC)).

[143] In any event, the terms of the executed Relentless-Yangarra PSA and the testimony of both Yagarra’s and Relentless’ representatives in the transaction objectively demonstrate that the substantive consideration lay in the benefits each party derived from the terms of the agreement as opposed to the nominal $1.00 consideration: Yangarra received an undivided interest in the Crown Lease and Relentless rid itself of the environmental liability for the 4-7 Well. This is further supported by the fact that the checklist of items in the witnessed Closing Agenda ensure the conveyance of the Crown Lease and the well license to Yangarra, but do not mention the $1.00 nominal consideration or any other monetary payment as a condition to closing. If the $1.00 was an “amount owing at Closing” requiring payment pursuant to Clause 3.03 of the

CAPL Transfer Procedure for the transaction to close, surely that amount would have been included in the Closing Agenda.

[144] To find that the Relentless and Yangarra transaction is unenforceable also risks trenching on the parties' freedom to contract. Given that Relentless has not sought to repudiate the PSA based on the non-payment of the $1.00, we can only assume that they either acquiesced to the non-payment or never intended for it to happen. A finding otherwise based on the submissions of a party that has no privity to the transaction would set a dangerous precedent for the validity of transactions that incorporate a nominal purchase price where the substance of the transaction is not actually monetary. I find the transaction under the Relentless-Yangarra PSA effected the transfer of the legal interest in the Crown lease to Yangarra. Notwithstanding that the nominal purchase price was never paid, the record demonstrates that the common law requirements for a valid arm's-length transaction were otherwise met (see paragraph [134]).

B. As two legal interests, does PrairieSky's 8% Royalty have priority over Yangarra's interest in the Crown Lease?

[145] Where, as here, there are two competing legal interests in the same property — Yangarra's interest in the Crown Lease and PrairieSky's 8% Royalty that runs with the Crown Lease — priority is determined based on chronology and the *nemo dat* maxim applies: "no one can give what they do not have" (Ziff at 460). If A conveys legal title to B, and subsequently to C, legal title will have vested in B. Since A no longer had legal title to give to C, A could not transfer title to C. Priority therefore goes to B, the first party to acquire their legal interest (***Bank of Montreal v Innovation Credit Union***, 2010 SCC 47 at para 51 [***Innovation***]). The principle also applies to prior legal interests that encumber the legal title conveyed by A. As explained by Professor Ziff (Ziff at 460):

> [A] purported sale of Blackacre by B to C, when title was properly in A, gives C nothing. Here, the *nemo dat* rule governs. The rule allows A to rest comfortably, knowing that no such transaction could destroy or affect the state of title. The doctrine shouts *caveat emptor* (buyer beware). Accordingly, C must make sure that B has some worthwhile title to give. C must also be alive to the possibility that some other legal interest affects's B's title. If prior to the sale to C, A had been granted a lease, legally perfect in all respects, that right would also bind C. Notice would be irrelevant. [emphasis added]

[146] At the time Yangarra acquired its interest in the Crown Lease, PrairieSky already held a legal interest that ran with the Crown Lease. Therefore, Yangarra could only take its interest subject to PrairieSky's prior legal interest (***Innovation*** at para 51; Ziff at 460; Thackray at § 7.75). Here, it is not the case that Relentless did not have a 100% undivided interest in the Crown Lease to transfer to Yangarra as the *nemo dat* principle classically contemplates. Rather, Relentless didn't have a lease free and clear of royalties to transfer to Yangarra — it had a lease encumbered by both the 2% GOR and the 8% Royalty. The Crown Lease would be inherently more valuable free and clear of the 8% Royalty, thus constituting a "greater" interest than Relentless had to offer.

[147] This rationale also finds support in the following passage from Thackray (at § 7.75), which contemplates the very scenario in the present case:

> Assuming a royalty agreement creates an interest in land, the royalty owner is not subject to the limitations of some of the rules of contractual privity and, subject to rules relating to the priority of competing interests, the royalty owner can enforce payment of the overriding royalty against any third party who acquired the working interest....If the working interest arises out of a Crown lease, the overriding royalty is unregistrable and the common law rules of priority apply. In general, an overriding royalty which is an interest in land will have priority over all other interests in the Crown lease which arise or are granted subsequent to the overriding royalty and will be subject to all interests which arise prior to the royalty. [Emphasis added]

[148] The rule that a royalty constituting a legally recognizable interest in land takes priority over subsequent legal interests in the underlying estate also upholds the policy reasons embraced by the ***Dynex ABCA*** and ***Dynex*** courts for finding that royalties can be interests in land in the first place. In order for royalties to play their useful role in financing and spreading risk in upstream extractive industries, investors must have some certainty of continuity regarding their royalties when the title or working interest in the property in which they've invested changes hands. If Royalties were extinguishable upon the underlying interest changing hands without the subsequent acquiror's knowledge of the royalty, there would be no point in labelling them interests in land.

C. The defence of *bona fide* purchaser for value does not apply

[149] Notwithstanding the substantial submissions by both parties as to whether Yangarra is a BFPV, the defence of BFPV does not apply in the circumstances. BFPV is an equitable defence that arises where a subsequent legal interest is acquired without notice of a prior equitable interest. The principle was described by the Supreme Court of Canada in ***i Trade Finance v Bank of Montreal***, 2011 SCC 26 at para 60, quoting Lionel D Smith, *The Law of Tracing*, (Oxford: Clarendon Press, 1997) at 386:

> The full name of the equitable defence is 'bona fide purchase of a legal interest for value without notice of a pre-existing equitable interest.' The effect of the defence is to allow the defendant to hold its legal proprietary rights unencumbered by the pre-existing equitable proprietary rights. In other terms, where the defence operates, the pre-existing equitable proprietary rights are stripped away and lost in the transaction by which the defendant acquires its legal proprietary rights.

[150] Here, there are two competing legal interests for which the equitable doctrine of BFPV does not apply.

D. Conclusion as to the priority of competing interests

[151] First principles regarding the priority of competing interests dictate that PrairieSky's 8% Royalty was first in time and therefore has priority over Yangarra's subsequent legal interest in the Crown Lease. The 8% Royalty is therefore binding on Yangarra.

[152] The only recourse available to Yangarra in the circumstances would be to claim fraud or negligence on the part of Relentless: "[a]s between two legal or two equitable interests the first in time will prevail unless the subsequent taker, in good faith and for valuable consideration, has been misled by the fraud or negligence of the prior taker or his representative" (Oosterhoff and Rayner at § 3202).

[153] The potential remedies available to Yangarra do not, however, concern PrairieSky. If Yangarra was indeed misled by fraud or negligence, its claim would be against Relentless. PrairieSky cannot be held responsible for transactions between third parties that result in the transfer of the underlying interests its royalties attach to. Nor should PrairieSky be forced to hunt down anyone but the current successor in interest to the Crown Lease for payment of its 8% Royalty.

E. Expert Evidence and Proposed Expert Evidence

[154] Both parties filed expert reports addressing aspects of the defence of BFPV and both parties called their experts to testify. Those reports were filed in accordance with the Rules of Court. I had no qualms or reservations about PrairieSky's proposed expert and I qualified him without reservation after hearing evidence of his qualifications. Had I been required to decide whether Yangarra had made out the defence of BFPV, PrairieSky's expert report and testimony would have been very useful to the Court in making that assessment. PrairieSky's expert was a land professional with many years' experience in conducting oil and gas transactions. His knowledge and experience were highly relevant and on point.

[155] On the other hand, having read Yangarra's proposed expert's report in advance of his testimony, I had reservations as to whether the nature of his experience in oil and gas transactions would be helpful in assessing whether Yangarra had made out the defence of BFPV. Although the proposed witness has had many years' experience in the oil and gas industry and has had a very successful career in the industry, it was not clear to me that the nature of that experience would be helpful to the court, if called upon to assessment whether Yangarra had made out the defence of BFPV. Those reservations were not allayed when Yangarra's counsel led evidence of their proposed expert's qualifications, and even less so after PrairieSky's counsel questioned him on his qualifications. Given that Yangarra's proposed expert's testimony came on the last day of trial, I reserved my decision on whether he should be qualified as an expert and heard his evidence. After having heard his evidence, and particularly after Ms. Poppel's skillful and highly effective cross-examination, even if I had qualified Yangarra's proposed witness as an expert, I do not believe that his evidence would have assisted the Court in assessing whether Yangarra had made out the defence of BFPV.

VI. Issue 3: What remedy, if any, is appropriate?

[156] PrairieSky submits that the Court has broad discretion to fashion an appropriate remedy. In that regard, PrairieSky seeks a declaration that the 8% Royalty is an interest in the Lands, which attaches to the Lands, and is binding on Yangarra and all subsequent working interest owners of the Lands. Given my reasons, I agree that such a declaration is an appropriate remedy and should be made.

[157] At trial, PrairieSky led evidence as to the amount of its damages for the period of April 1, 2017 to December 2021. This evidence was largely if not completely uncontested by Yangarra. PrairieSky provided detailed calculations fixing its damages for that period in the amount of $213,397.60. I accept those calculations reflect the accurate measure of PrairieSky's damages for that period and judgment should issue accordingly.

[158] PrairieSky also seeks an order directing Yangarra to produce to PrairieSky, within 30 days of the issuance of these reasons for judgment, and monthly thereafter, production volumes for the 4-7 Horizontal Well for crude oil, gas, methane, butane, ethane, pentane, and propane

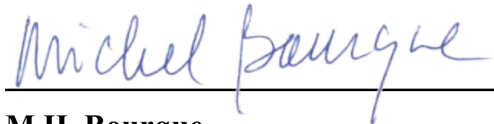
from January 2022 onwards as well as the prices Yangarra obtained for production from the 4-7 Horizontal Well for each of crude oil, gas methane, butane, ethane, pentane, and propane from January 2022 onwards. Given my reasons and, as far as I am aware, Yangarra has continued to produce from the 4-7 Horizontal Well, the order requested is appropriate.

[159] PrairieSky is presumptively entitled to costs. If the parties are unable to agree as to costs, they may contact the judicial scheduler to arrange for a brief appearance.

[160] I thank counsel for their excellent briefs and thorough submissions.

Heard on March 28, 29, 30, and 31, April 1, and June 17, 2022.
Written Submissions filed on May 6, May 24, 2022 and June 3, 2022.

Dated at the City of Calgary, Alberta this 6th day of January, 2023.



M.H. Bourque
J.C.K.B.A.

Appearances:

Laura M. Poppel and Emma Morgan
for PrairieSky Royalty Ltd.

Warren Foley and Ram Sankaran
for Yangarra Resources Ltd.