Court of King's Bench of Alberta

Citation: Invico Diversified Income Limited Partnership v NewGrange Energy Inc, 2024 ABKB 214

Date: 20240412
Docket: 2301 16260
Registry: Calgary

Between:

Invico Diversified Income Limited Partnership, by its general partner, Invico Diversified Income Managing GP Inc.

Applicant

- and -

Newgrange Energy Inc.

Respondent

Reasons for Decision
of the
Honourable Justice M.H. Hollins

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1. Introduction

[1] Free Rein Resources Ltd. (Free Rein) is an insolvent company in proceedings under the *Companies' Creditors Arrangement Act*, RSC 1985, c.C-36 (*CCAA*). Invico Diversified Income Limited Partnership (Invico) has applied for approval of a Reverse Vesting Order (RVO) authorizing its purchase of the business and property of Free Rein, its debtor.

[2] The primary issue on this application was not the use of the reverse vesting mechanism itself but rather what interests could be "vested out" i.e. removed from title to the assets being purchased. Specifically, Invico seeks to remove two Gross Overriding Royalties (GORs) from title to the lands it is purchasing and to transfer, or vest out, those GORs to a residual trust as unsecured claims. It is conceded by Invico that there will not be sufficient funds paid into the residual trust to provide any payment to those royalty holders from the trust.

[3] NewGrange Energy Inc (NewGrange) objects on its own behalf and on behalf of the Shareholders (defined later), both of them holding GORs, to those GORs being vested out, arguing that they are interests in land which run with the land and which cannot or should not be stripped from title passing to Invico. Invico argues that these GORs are not interests in land and even if they are, they should be vested out in any event.

[4] For the reasons that follow, Invico's application is granted. Its credit bid and resulting acquisition of the business and assets of Free Rein is the best option available and satisfies the statutory and common law requirements for approving the sale. Further, this is an appropriate

case for employing the reverse vesting mechanism, largely because of the existing oil and gas permits and licences in place. Lastly, the NewGrange GOR and the Shareholders' GOR will be among the claims vested off into the residual trust as they do not constitute interests in land.

[5] After a brief review of the factual and procedural background, I will explain why the RVO is the appropriate mechanism in this case and then will address the request to vest out the GORs.

2. Background

[6] In June of 2018, NewGrange purchased oil and gas assets (called the Golden Spike Asset, herein the "Asset") out of the receivership of Questfire Energy Corporation. NewGrange paid $250,000 in addition to assuming some liabilities associated with the Asset. Purvida Exploration Inc (owned by Sean Addison) and 1591195 Alberta Ltd (owned by Andy Prefontaine) contributed to the purchase price. NewGrange (owned by Terry McCallum) borrowed its share of the contribution to the purchase price, which it has since repaid.

[7] NewGrange, assisted by Purvida and 1591195, then attempted to sell the Asset for $2M plus a 5% GOR but could not find any buyers at that price. With no prospective buyers, Mr. McCallum decided to raise money to produce the oil and gas himself. To do this, he purchased the majority of shares of Free Rein, a company with regulatory licences in place that made it easier for Free Rein to find investors. Free Rein ultimately purchased the Asset from NewGrange in November, 2018 for $750,000 cash plus a 5% GOR granted back to NewGrange.

[8] Another GOR was granted by Free Rein in March of 2023, this time to the Free Rein Shareholders (defined as those individuals and companies listed in Exhibit "I" to the McCallum Affidavit filed February 15, 2024) who collectively provided $150,000 that Free Rein needed to recomplete a particular well.

[9] By a loan agreement dated September 21, 2022 and amended on April 18, 2023, Invico advanced funds to Free Rein. Free Rein defaulted on those loan obligations shortly thereafter. Free Rein filed a Notice of Intention on June 12, 2023 to make a proposal under the *Bankruptcy and Insolvency Act*, RSC 1985, c.B-3 (*BIA*). A sale and investment solicitation process (SISP) was approved on August 25, 2023 which resulted in two bids, in addition to Invico's stalking horse bid.

[10] However, before that process could be concluded, the gas plant which processes all of Free Rein's gas, Tidewater Midstream and Infrastructure Ltd, terminated its contracts with Free Rein, claiming force majeure. Because no other gas processing option is feasible for this Asset, the gas wells were shut in. Since then, the regulator has allowed only isolated production to flare off the sour gas. The oil wells continue in production but they are only approximately 1/3 of Free Rein's total production. The Tidewater termination was therefore a material adverse change which caused the prospective purchasers to withdraw their bids. The *BIA* proceeding was then converted into a proceeding under the *CCAA* and FTI Consulting Ltd. (FTI) was appointed as Monitor.

[11] As the SISP process has effectively been exhausted, ultimately resulting in no viable third party purchasers, Invico now proposes to acquire 100% of Free Rein's shares by way of credit

bid, in exchange for the forgiveness of approximately $6.5M in debt owed to Invico.[1] In addition, Invico will assume certain liabilities attached to the assets being transferred and make a cash payment of approximately $650,000 for court-ordered charges and statutory priorities.

[12] I will first address the suitability of the RVO mechanism and then address Invico's request to vest out the NewGrange and Shareholders' GORs.

3. Reverse Vesting Orders

[13] RVOs can be an appropriate vehicle for the sale of insolvent companies or their assets in *CCAA* proceedings. Because an RVO vests title to shares and/or assets directly in the purchaser, as opposed to offering them to open market, additional scrutiny is required to ensure that the sale is fair and reasonable. Further, because RVOs generally involve the creditor taking some assets and liabilities while disclaiming others, courts have a heightened role in ensuring that doing so does not work an avoidable unfairness to affected parties.

[14] Any sale in a *CCAA* proceeding, whether through an RVO or otherwise, must answer the questions in s.36(6) *CCAA* as follows (paraphrased):

(a) Was the process leading to the proposed sale reasonable?

(b) Does the Monitor approve the proposed sale?

(c) Has the Monitor opined that the proposed sale would be more beneficial to creditors than a sale under a bankruptcy?

(d) Were the creditors consulted?

(e) How will the creditors and other interested parties be affected?

(f) Is the consideration offered fair and reasonable?

[15] These factors were reviewed in *Royal Bank v Soundair Corp*, 1991 CarswellOnt 205 at para.16, in which the Ontario Court of Appeal also focussed on the efficacy, integrity and fairness of the process generally.

[16] The SISP was granted by this Court on August 25, 2023. FTI has filed its Reports outlining its compliance with the SISP Order, including going through both Phase I and Phase II of the SISP process. That resulted, as mentioned, in three bids; two independent bids and Invico's own stalking horse bid.

[17] The process was conducted fairly and over an appropriate length of time, allowing numerous potential offerors to participate. The only reason the sales process under the SISP did not proceed to conclusion was Tidewater's termination of the processing contracts, leading to the shutting in of the majority of the wells in the Asset and the existing bidders aborting their bids. The Monitor has been supportive of all the steps in the proceeding, including the conversion to a *CCAA* proceeding, the SISP and now the RVO in the form sought. I am satisfied that the relevant factors in s.36(6) *CCAA* and *Soundair* have been sufficiently and fairly addressed.

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[1] Invico's debt is quantified differently in different places in the filed material, ranging from $6.3-$6.7M. I have not attempted to discern this with certainty because the debt, at either end of that range, vastly exceeds the value of the assets which are the subject of the proposed transaction.

[18] However, as mentioned, there are additional factors to consider in granting an RVO. Neither the *BIA* nor the *CCAA* explicitly authorize an RVO, it is now accepted that ss.11 and 36(6) *CCAA* (in this case) provide the authority to grant an RVO where it is "appropriate in the circumstances"; see *Southern Star Developments Ltd v Quest University Canada*, 2020 BCCA 364 at para.11.

[19] Notwithstanding that authority, an RVO is still supposed to be an "extraordinary" measure; *Harte Gold Corp (Re)*, 2022 ONSC 653 at para.38. Presumably this is because, while it creates favourable conditions for the RVO purchaser, it has the potential of being unfair to other stakeholders. For example, an RVO circumvents the debtor making a plan or a proposal and may therefore be misused to thwart particular creditors or stakeholders who would otherwise have a right to participate in the approval or rejection of the proposal in the creditor class vote. Further, where the proposed purchase under an RVO is a credit bid, there may be a concern about fair value being paid for what is being purchased because, *inter alia*, the RVO structure affords intangible benefits to the purchaser that would not be enjoyed under the more conventional Sales and Vesting Order (SAVO).

[20] As a result, the following additional questions must be answered:

(a) Why is the RVO necessary?

(b) Does the RVO structure produce an economic result that is at least as favourable as any other viable alternative?

(c) Is any stakeholder worse off under the RVO structure than they would have been under another viable alternative? and

(d) Does the consideration being paid reflect the value of the intangible assets being preserved under the RVO?

Harte Gold (Re), ibid.

[21] An RVO may be necessary where the debtor is operating in a highly regulated industry and holds regulatory permits and licences that a purchaser would, in the normal course, have to obtain in its own name, by application or assignment. This involves a great deal more time and cost than assuming the existing permits and licences, with all the attendant obligations of course.

[22] The same may be true of existing contracts to which the debtor is a party and of existing tax attributes that would be lost if the assets were simply sold to a new purchaser under a SAVO; *Just Energy Group Inc v Morgan Stanley Capital Group Inc*, 2022 ONSC 6354 at para.34.

[23] Chris Wutzke, Invico's Chief Investment Officer, has deposed that Invico is proposing to retain all oil and gas licences, all software licences, all agreements relating to specific projects and all regulatory attributes of Free Rein; Paragraphs 19, 28 of Wutzke Affidavit #3 sworn and filed February 2, 2024.

[24] Is Invico paying a fair price for the Free Rein assets? A credit bid in these circumstances can be hard to evaluate. On one hand, Invico is receiving an asset that the free market valued at something less than $2M, excluding the GOR, in exchange for the forgiveness of $6.5M in debt. But if Free Rein is put back into bankruptcy proceedings with no imminent purchaser, the remaining producing wells will likely be shut in and devolve to the Orphan Well Association, leaving Invico with no recovery at all. Accordingly, the actual value of the debt forgiveness may be something less than $6.5M, given that the only other option is for Invico to receive nothing.

[25] However, Invico would also be assuming the liabilities associated with operating these wells, hopefully allowing them to stay or come back into production. There is additional value in that, as well as in retaining the existing employees.

[26] In terms of alternative scenarios, there simply are none, which is why the Monitor is supporting the current proposal. In the proposed RVO, Invico is better off than in a bankruptcy, but so are any employees, the priority creditors and even the industry, to the extent that the Orphan Well Association's costs and liabilities are so funded.

[27] NewGrange and the Shareholders are not actually any worse off in the RVO than they would otherwise be. They will recover nothing in either the proposed RVO or in a bankruptcy. However, that is not because of the RVO structure. Whether this was a standard SAVO or an RVO, the amount of Invico's debt would always have meant that there was nothing left for subordinate creditors.

[28] In fact, neither NewGrange nor the Shareholders oppose the RVO in principle. They simply oppose their GORs being vested out to the residual trust, which is dealt with later in these Reasons.

[29] Given the foregoing, I find that the *Harte Gold* factors have been met and this is an appropriate case to employ the RVO format.

4. Gross Overriding Royalties

[30] The primary dispute in this case was whether the NewGrange and Shareholder GORs are interests in land which "run with the land". If so, then the court's ability to vest them out would be restricted and subject to further considerations. If not, those claims could be vested out as unsecured contractual claims against the residual trust and the assets would pass to Invico free and clear.

[31] There are two ways in which Invico can establish its entitlement to vest out the GORs; (1) by proving that the GORs are not an interest in land; or (2) by proving that, even if the GORs are an interest in land, it is equitable and appropriate to vest them out anyway.

[32] NewGrange and the Shareholders maintain that the language of their Royalty Agreements, defined *infra*, makes it clear that the parties intended to and did convey an interest in land. Invico says that, looking at the Royalty Agreements themselves and the circumstances of the transaction, these GORs were not treated as interests in land.

(a) GOR as an Interest in Land: The *Dynex* Test

[33] It is now settled law that a GOR can be an interest in land. Justice Bourque recently did a comprehensive review of this legal evolution, which I will not repeat here; *Prairiesky Royalty Ltd v Yangerra Resources Ltd*, 2023 ABKB 11 at paras.23-40. See also, D. LeGeyt et al "Let's Talk About Royalties: The Continued Uncertainty Surrounding the Creation and Legal Status of the Overriding Royalty", 57 Alta. Law Rev. 335 (2019).

[34] However, a GOR can also be a contractual right to receive royalty payments without constituting an interest in land. In *Vandergrift v Coseka Resources Ltd*, (1989) 95 AR 372, Virtue, J of this Court set out a two-part test for determining whether a GOR was, in fact, an interest in land. That test, set out below, was adopted by Major J of the Supreme Court of Canada and is often called the *Dynex* test:

A royalty which is an interest in land may be created from an incorporeal hereditament such as a working interest or a *profit à prendre*, if that is the intention of the parties.

Virtue J. in *Vandergrift , supra*, at p. 26 succinctly stated:

... it appears reasonably clear that 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.

Bank of Montreal v Dynex Petroleum Ltd, 2002 SCC 7 at paras.21-22

(i) *Dynex* Part I – Contractual Interpretation

[35] To ascertain the intentions of the parties, we must employ the principles of contractual interpretation. I can do no better than the summary from Horner, J in *Accel Canada Holdings Limited (Re)*:

> When interpreting an agreement, a court must read the contract "as a whole, giving the words used their ordinary and grammatical meaning, 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 (S.C.C.) at para 47. Nonetheless, while surrounding circumstances are important considerations, they must not overwhelm the words of the contract or effectively create a new agreement contrary to the wording of the agreement itself: ***Sattva*** at para 57.
>
> It is important to consider the surrounding circumstances, also referred to as the "factual matrix", of an agreement because "words alone do not have an immutable or absolute meaning": ***Sattva*** at para 47. Therefore, courts must consider the surrounding circumstances regardless of whether or not a contract is ambiguous; failing to consider the surrounding circumstances when interpreting a contract is a reversible error: *IFP Technologies (Canada) Inc. v. EnCana Midstream and Marketing*, 2017 ABCA 157 (Alta. C.A.) at paras 57, 58, leave to appeal to SCC refused 37712 (5 April 2018) [2018 CarswellAlta 666 (S.C.C.)].
>
> ...
>
> The evidence that can be relied upon to determine the "surrounding circumstances" varies from case to case: *Sattva* at para 58. Evidence of surrounding circumstances should only consist of objective evidence about the background facts at the time of the contract execution. The evidence must have

been, or reasonably ought to have been, within the knowledge of both parties at the time of or prior to the contract execution: *Sattva* at para 58.

Determining what constitutes surrounding circumstances is a question of fact: *IFP Technologies* at para 83. Surrounding circumstances are relevant background facts that are likely not controversial to the parties and are capable of affecting how a reasonable person would understand the language of the document: *Alberta Union of Provincial Employees v. Alberta Health Services*, 2020 ABCA 4 (Alta. C.A.) at para 25 [*AUPE*]. Relevant background facts include those that speak to:

1) the genesis, aim or purpose of the contract;

2) the nature of the relationship created by the contract; and

3) the nature or custom of the market or industry in which the contract was executed: *IFP Technologies* at para 83.

Accel Canada Holdings Limited (Re), 2020 ABQB 182 at paras.17-18 and 20-21 (NB: leave to appeal was refused on an alleged error in applying the law of contractual interpretation; *Third Eye Capital v B.E.S.T. Active 365 Fund*, 2020 ABCA 160).

(ii) Dynex Part II – *Nemo Dat Quad Non Habet*

[36] The second arm of the *Dynex* test for whether a GOR is an interest in land is whether the interest of the grantor, from which the GOR is carved out, is itself an interest in land. I have averted to the maxim '*nemo dat quad non habet*' which simply means that one cannot give what one does not have.

[37] While the origin of this part of the Dynex test concerned itself with the nature of what was owned in relation to what was granted, the application of this principle to the NewGrange GOR is concerned with the timing of granting something you do not own yet. This is discussed below in paras.90-105.

[38] Accordingly, I will examine the language of the Royalty Agreements, including how each GOR was treated within the contracts and within the transaction. Although the Dynex test applies equally to the NewGrange and the Shareholder GOR, the language used and the surrounding circumstances of each is different, so I will address them in turn.

(b) The NewGrange GOR

(i) The 2018 Transaction

[39] Terry McCallum is the principal actor here. He is the sole owner of NewGrange. In order to buy the Asset from the Questfire receivership in 2018 for $250,000, he got money from his associates Sean Addison of Puravida ($50,000) and Andy Prefontaine of 1591195 Alberta Ltd ($75,000). McCallum borrowed the rest of the funds himself, which he subsequently repaid.

[40] NewGrange then signed Work Agreements and Marketing Agreements with Puravida and 1591195 Alberta Ltd, promising them 20% and 30% respectively, of any financial benefit

derived by NewGrange, whether in cash or in the form of a royalty[2]. Those companies, represented at this hearing, supported NewGrange's position that the GORs were interests in land.

[41] Unable to find a buyer for the Asset on an "as is" basis for $2M plus a 5% GOR (which would have been a 700% profit less the GOR), McCallum elected to put the Asset into production to make it more attractive to prospective buyers. He did this by selling the Asset to Free Rein. Free Rein had no oil and gas assets of its own but held AER licences that NewGrange did not have. Free Rein was owned by McCallum's friend, Edward Jakubowsky, who agreed to transfer 98% of the shares of Free Rein to McCallum for $1.00, effectively making McCallum the grantor and the grantee of the GOR.

[42] Free Rein resolved to sell $1 shares. There was no evidence of what third party investments were made in 2018, if any but by the fall of 2018, McCallum was satisfied that they would eventually raise enough money to develop the Asset. NewGrange then sold the Asset to Free Rein for $750,000 plus a 5% GOR granted back to NewGrange.

[43] The Asset Purchase Agreement (APA) was signed on November 1, 2018 and closed on November 30, 2018. Schedule "C" to the APA was the Royalty Agreement between Free Rein and NewGrange, which had been signed previously, on October 30, 2018.

[44] The evidence of this background comes from the Affidavits of Terry McCallum and of Chris Wutzke. NewGrange objected to the admission of Wutzke's evidence because it was largely hearsay. This is true. The GOR was granted in the course of a 2018 transaction before Invico loaned any money to Free Rein. However, Mr. Wutzke was not purporting to give evidence about what Mr. McCallum and his associates subjectively thought or intended in 2018. He could not, firstly because he was not there but also because evidence of subjective intent is inadmissible.

[45] There is no danger to admitting Mr. Wutkze's evidence, which is either his own knowledge of the current state of the Asset and the proposed RVO or which attaches documents from the 2018 transaction between Free Rein and NewGrange. Although this would be admissible under the principled exception to hearsay anyway – being both necessary and reliable – it may be preferable to simply emphasize that the intentions of the parties must be gleaned from a review of the known and agreed facts and documents from that time, not from evidence about the parties' subjective thinking; *IFP Technololgies (Canada) Inc* v *EnCana Midstream and Marketing*, 2017 ABCA 157 at paras 57 and 127.

(ii) The Granting Clause

[46] In this case, NewGrange relies completely on the language of Clause 2(a) of the NewGrange Royalty Agreement:

> *[NewGrange] does hereby reserve to itself and [Free Rein] does hereby grant to [NewGrange] the Overriding Royalty on the Royalty Lands as described in this Royalty Agreement and based upon the working interest of the Royalty Payor [Free Rein] as set forth in the attached Schedule "A" or Schedule "A-1". The*

[2] This arrangement is the subject of other litigation. I do not intend for my passing comments on it to indicate any opinion on the merits of any positions taken in that lawsuit.

> *Overriding Royalty is intended to be an interest in land in the Royalty Lands and to be a covenant running therewith.*

[47] The "Overriding Royalty" is defined as the percentage of Petroleum Substances produced from the Royalty Lands calculated in accordance with the provisions of the Royalty Agreement.

[48] Simply calling something an interest in land does not, by itself, make it so. However, where parties have used clear language to describe their mutual intention to create an interest in land, that can be overcome only by clear and objective evidence which indicates otherwise; what Bourque, J has characterized as a rebuttable presumption; *PrairieSky* at para.63.

[49] The granting language in the NewGrange Royalty Agreement could fairly be characterized as the "magic words" which evidence the parties' intention to create an interest in land. However, it was our Court of Appeal in *Dynex* that warned that focussing only on "magic words" without considering the substance of the transaction was an improper approach; *Bank of Montreal v Dynex Petroleum Ltd*, 1999 ABCA 363 at para.73; see also *Prism Resources Inc v Detour Gold Corporation*, 2022 ONCA 326 at paras.13-14.

[50] NewGrange objected strenuously to consideration of anything outside the granting language. Its Brief wrongly conflates surrounding circumstances with parol evidence (paras.30-31 of that Brief) and simply declares that the surrounding circumstances are "irrelevant" in the face of Clause 2(a) of the GOR. The law is clear that surrounding circumstances cannot be irrelevant. In fact, failing to consider them would be a reviewable error:

> One error of law reviewed for correctness is where the trial judge fails to consider the "surrounding circumstances" or "factual matrix" of a contract. A trial judge must consider the factual matrix in interpreting a contract regardless of whether the contract is ambiguous. Therefore, it is an error for a trial judge to discount the factual matrix on the basis that the contract itself is not ambiguous: *British Columbia (Minister of Technology, Innovation and Citizens' ervices) v. Columbus Real Estate Inc.*, 2016 BCCA 283 (B.C. C.A.) at paras 40, 51, (2016), 402 D.L.R. (4th) 117 (B.C. C.A.); *Starrcoll Inc. v. 2281927 Ontario Ltd.*, 2016 ONCA 275 (Ont. C.A.) at paras 16-17, (2016), 68 R.P.R. (5th) 173 (Ont. C.A.).
>
> *IFP Technologies (Canada) Inc v EnCana Midstream and Marketing*, 2017 ABCA 157 at para.58

[51] This type of clear granting language, along with evidence of registration of the GOR on title (which was done here), has generally been sufficient to declare a GOR to be an interest in land. However, in most of those cases, there was no evidence of any contrary intention.

[52] For example, In *Third Eye Capital v Dianor Resources Inc*, the challenging party relied on the outdated argument that an interest in land must be accompanied by a right of the royalty holder to enter onto the land and produce the substance themselves, an argument rejected by the Ontario Court of Appeal; 2018 ONCA 253 *(Dianor #1*) at para.56.

[53] Similarly, in *PrairieSky*, Yangerra argued that a share of substances recovered from the land was necessarily a contractual right and could not be an interest in land. Bourque J rejected that argument as well, saying "Yangerra'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"; *PrairieSky* at para.85.

[54] In another case before our Court, *Manitok*, the landowner and the receiver were opposed to the royalty remaining on title. They argued, *inter alia*, that because the royalty was a right to share in production which decreased on a sliding scale over time, with no right of entry onto the land, the royalty could not be an interest in land. Relying on *Dynex*, Horner J concluded that "even a "net profits interest" could be an interest in land if the parties made the intention to make it so sufficiently clear"; *Manitok Energy Inc (Re)*, 2018 ABQB 488 at paras. 19 and 22.

[55] A case finding otherwise was *Accel (Re)*, the 2020 case also before Horner J. In that case, despite clear granting language, she found that the GOR was a security interest, not an interest in land. Among other things, the GOR was only triggered by non-payment of the installment purchase price and thus was characterized as a security interest rather than an interest in land. Leave to appeal on this issue was refused; 2020 ABCA 160.

[56] Is Clause 2(a) of this Royalty Agreement contradicted by other language or aspects of the transaction to the extent that the GOR cannot be an interest in land, notwithstanding the granting language?

(iii)Inconsistencies Relied on by Invico

[57] As mentioned, Invico argues that a number of elements of the transaction, including within the Royalty Agreement itself, are inconsistent with the grant of an interest in land and are indicative of an intention to grant only a contractual right to a royalty payment. Summarized, these are:

(a) The Royalty Agreement purports to grant interests in AMI lands, not identified or owned by the grantor;

(b) The Free Rein Directors' Resolution authorizing the purchase from NewGrange and the granting of the GOR to NewGrange said the royalty would only be paid while "commercially reasonable" for Free Rein to do so; and.

(c) The assignment clause of the Royalty Agreement describes a contractual obligation that follows Free Rein, not the land.

A. The AMI Issue

[58] Free Rein granted to NewGrange "the Overriding Royalty on the Royalty Lands as described in this Royalty Agreement and based upon the working interest of the Royalty Payor as set forth in the attached Schedule "A" or Schedule "A-1"; Clause 2(a) of the Royalty Agreement.

[59] The Royalty Lands are defined as the "lands set out in Schedule "A" (or that may hereafter be made subject to a gross overriding royalty...by virtue of Area of Mutual Interest or otherwise)".

[60] Schedule "A" to the Royalty Agreement lists the five Crown leases. These leases correspond to the registrations of the GOR against four of the five leases (Exhibit "D" to Wutzke Affidavit #3). The last, NW 35-51-27 W4M, in which Free Rein holds a 5% ownership interest, was on a schedule to the APA. In any event, I understood the NewGrange GOR to be registered against all subject Crown leases.

[61] There is no Schedule A-I to the Royalty Agreement, notwithstanding that reference in Clause 2(a). There is a Schedule B titled "Mutual Interest Lands". Clause 16 of the Royalty

Agreement says that if Free Rein acquires any mutual interest lands within 2 years of the "Acquisition Date" (which purports to be set forth in Schedule "A" but is not), Free Rein must notify NewGrange of any such acquisition. Any such interest acquired is deemed to be subject to NewGrange's GOR and the parties would be obligated to amend Schedule "A-1" (non-existent) in writing.

[62] Clause 16 also provided that if further areas, outside the Mutual Interest Lands, were acquired (no time limit on this), the parties could agree in writing to amend Schedule "A" to the Royalty Agreement to incorporate such acquisition(s). If they did, they were also to amend Schedule "B" to "incorporate this [new] area of mutual interest". It was acknowledged that unless and until the parties mutually amended Schedules "A" and "B", there were no royalty obligations created in any additional, non-AMI, lands.

[63] Invico argued that this future unidentified interest in land could not give rise to an interest in land capable of being granted on October 30, 2018. Free Rein had no interest in any AMI lands on October 30, 2018, and there was no certainty as to what, if anything, it would ever acquire under Clause 16 to the Royalty Agreement.

[64] This is a variation of the application of the principle of *nemo dat quod non habet* – one cannot grant what one does not have – that is discussed in more detail later.

[65] I agree with Invico. The most that could be created with respect to future acquisitions was a contractual right of NewGrange to have the Royalty Agreement amended to include such acquisitions in the lands generating a royalty (i.e. under Schedule "A").

[66] However, once that contractual right was exercised and Schedule "A" amended, conceptually, the additional lands and the royalties derived therefrom would be treated in the same manner, legally, as the original GORs. They would either be interests in land or they would not be. In other words, if the original GOR was truly an interest in land, the Royalty Agreement envisioned that the later-acquired royalty in later-acquired land would similarly be an interest in land, once the Royalty Agreement was amended to include it.

[67] This does not necessarily assist NewGrange with the underlying issue of whether the original royalty was an interest in land to begin with. However, neither does it operate the way that Invico suggests; that any reference to the possibility of acquiring future royalty rights meant that those granted on October 30, 2018 were not true interests in land. An option on future acquisitions might not itself be an interest in land but it does not impact the proper characterization of interests existing at the time of granting. In other words, this is a neutral factor.

B. The Directors' Resolution

[68] Another of Invico's arguments was that the Free Rein Directors' Resolution authorizing the purchase of the Asset and the granting of the GOR to NewGrange did not treat the royalty as an interest running with the land.

[69] Edward Jakubosky and Terry McCallum, as the two directors of Free Rein, signed a Directors' Resolution dated December 15, 2018, resolving:

> *That [Free Rein] acquire an Asset, as of October 27, 2018, known as the Questfire Asset, being mineral rights in the Golden Spike area, from NewGrange Energy.*

> *In exchange for the Questfire Asset, the Corporation agrees to pay $750,000, grant a gross overriding royalty to Terry McCallum (or his nominee), paid* ***as long as it is commercially reasonable to do so,*** *and will assume all liabilities associated with the Questfire Asset.*
>
> *Following the acquisition of the Questfire Asset, [Free Rein] shall issue all future shares for $1.00. [emphasis added]*

[70] Invico says that Free Rein's reservation of the right to pay the royalty only "as long as it is commercially reasonable to do so" is incompatible with a true interest in land that runs with the land. It makes the payment of the royalty conditional on something discretionary and, at least potentially, extraneous to the land. This is compatible, Invico says, with a contractual right to receive the GOR but not with an interest in land because the GOR could be terminated while the underlying working interest continued uninterrupted. In other words, the working interest and the gross overriding royalty therein could run for different lengths of time.

[71] In the decision of our Court of Appeal in *Dynex*, one of the factors for determining whether an overriding royalty was an interest in land or not was whether or not the overriding royalty was capable of lasting for the duration of the underlying interest:

> As gleaned from the authorities, various indicia could be used to identify whether or not an interest in land was intended. The set of indicia, which is not exhaustive but may be relevant, is:
>
> 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.
>
> *Dynex*, ABCA, 1999 ABCA 363 at para.84.

[72] The Supreme Court of Canada upheld the Court of Appeal's decision in *Dynex* but articulated its test somewhat differently, incorporating the first and second of these suggested indicia (in reverse order) but not mentioning the third at all.

[73] I therefore conclude that while it may not be a requirement that an overriding royalty be capable of lasting for the duration of the underlying estate, it is still a factor to consider in characterizing an overriding royalty as an interest in land. It has been treated thus by our Court in *PrairieSky* and in *Manitok*.

[74] In *Manitok*, it was argued that because the royalty decreased over time, it could not be an interest in land. Horner J said:

> This leaves the Respondents' arguments that the fact that the Producing Royalty decreases over time, and includes lands from which Freehold may never receive Oil Volumes, weigh against the determination that the Producing Royalty is an interest in land. With respect to the former: the Royalty Agreement is carefully drafted so as to preserve the existence of the Producing Royalty until such time as the Documents of Title expire, while recognizing the reality of reservoir

> depletion. This suggests a conscious effort and careful drafting with a view to ensuring that the Producing Royalty meets the requirements for an interest in land.
>
> *Manitok* at para.24.

[75] While this Free Rein Directors' Resolution was not particularly careful to treat the GOR as an interest in land, it should be distinguished from cases like *Manitok* where the issue around contemporaneous interests was found in the royalty agreement itself.

[76] This Directors' Resolution was a document signed by the representatives of only one party to the agreement, Free Rein. Its enforceability, at least in terms of unilateral discretion to terminate the royalty payments to NewGrange, must be questionable. Other than the fact that Terry McCallum was also the sole shareholder of NewGrange, and therefore knew that Free Rein was so resolving, there is no evidence that NewGrange formally agreed to Free Rein reserving this discretion.

[77] One might say that "commercially reasonable" in the context of this transaction must simply refer to Free Rein's discretion to shut in wells where continued production was not commercially feasible. If that were the case, one might expect "commercially reasonable" to expressly modify production as opposed to the payment of the royalty. As drafted, this could conceivably refer to Free Rein's general financial health or commodity prices or labour availability or regulatory issues. One might also expect it to have been included in the Royalty Agreement so as to indicate some acceptance by the royalty holder of this discretion reserved to the royalty payor.

[78] Further, if it only refers to feasible production on which to pay the royalty, the clause is unnecessary as NewGrange only got a percentage of what was produced. If production was less or non-existent, there would be less or no royalty by the terms of the Royalty Agreement. Free Rein did not need to incorporate that causal connection between production and royalty payments in a Directors' Resolution.

[79] However, in the available jurisprudence dealing with the phrase "commercially reasonable" in the context of royalty payments on everything from oil and gas to books to patents, it has invariably been interpreted to mean a reference to the commercial feasibility of whatever underlying activity is generating the royalty.

[80] Whatever was meant by this unilateral Directors' Resolution, even to the extent that it may be inconsistent with the granting language in Clause 2(a), it cannot overwhelm the clear language used by both parties in the actual Royalty Agreement.

C. The Assignment Clause

[81] Clause 14 of the GOR reads, in part, as follows:

> *In the absence of an assignment in accordance with the foregoing [the 1993 CAPL Assignment Procedure] or Royalty Owner's written consent, Royalty Payor shall remain liable for the payment of the Overriding Royalty notwithstanding that it may no longer have any interest in the Royalty Lands from which such Petroleum Substances are produced, or that it may not be receiving the production or proceeds of production therefrom.*

[82] This language clearly envisions an independent right for NewGrange to receive the GOR that is separate and apart from the Free Rein's working interest in the land. If Free Rein assigns any of its interests in these leases without NewGrange's consent, it is liable to continue paying a gross overriding royalty to NewGrange whether or not it has the lands or even the proceeds of production.

[83] If the GOR truly ran with the land, this protection for the royalty holder would not be necessary because the assignee of Free Rein's interest would take title to the lands subject to NewGrange's GOR. In fact, in that event, this language creates the possibility of double recovery, at least conceptually. Obviously, such a claim advanced against Free Rein when it no longer owns the interest in land itself can only be a contractual claim.

[84] The assignment provisions of the royalty agreements in *Manitok* and *PrairieSky* were also argued to be inconsistent with clear granting language. In neither case did that argument prevail.

[85] In *Manitok*, the assignment clause said that if Manitok assigned its interest, it was obligated to provide the royalty holder with a substitute property producing a comparable royalty; *Manitok* at para.11

[86] In *PrairieSky*, Bourque J had an assignment clause that expressly contemplated a subsequent obligation to execute an assignment and novation agreement (recognition of the obligation by the assignee), reflecting "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 lands"; *PrairieSky* at paras.109-115.

[87] The language of the assignment clause in the NewGrange Royalty Agreement does neither of these things; it does not obligate Free Rein to find substitute land nor does it contemplate a novation by a new working interest owner/assignee. It simply says that the royalty will continue to be paid by a party no longer holding an interest in land, which then also fails the second arm of the *Dynex* test.

[88] I note that NewGrange argued that its Royalty Agreement was modelled on the 2015 CAPL template and thus, a finding that it did not successfully create an interest in land would be problematic for the entire oil and gas industry. Clause 14 of the NewGrange Royalty Agreement contains some similar language to the template but the sentence reproduced above does not appear in the 2015 version.

[89] I find that this language is fundamentally inconsistent with the granting language purporting to create an interest in land. Is it sufficiently inconsistent to overwhelm the language in Clause 2(a), to rebut the presumption created by that language?

D. Nemo Dat Quad Non Habet

[90] The second arm of the *Dynex* test for whether a GOR is an interest in land is whether the interest of the grantor, from which the GOR is carved out, is itself an interest in land.

[91] The Asset Purchase Agreement by which Free Rein acquired the Asset was signed on and dated November 1, 2018 but the defined "Closing Date" was November 30, 2018. By the terms of the APA, title to the Asset did not transfer from NewGrange to Free Rein until November 30, 2018. The APA did not purport to be effective on any other or prior date.

[92] Invico argues that that Free Rein could not grant an interest in land to NewGrange on October 30, 2018 because it did not have an interest of its own to grant at that time. Although Invico concedes that Free Rein's leasehold interests are interests in land, Free Rein did not take title to those leasehold interests until November 30, 2018. Free Rein had no interest to grant on October 30, 2018.

[93] It might have been possible to consider this argument under the first arm of the *Dynex* test, where we reviewed the language and circumstances of the transaction. Had I proceeded that way, I would have found that this factor weighed heavily against the parties' objective intentions to create an interest in land in the GOR.

[94] However, on reflection, I believe that this *nemo dat* argument properly belongs in the second arm of the *Dynex* test, as proposed by Invico. While, as I will explain, it is a somewhat different application of *nemo dat* than that in *Dynex*, it falls from the same inquiry, namely what did the grantor have to give? The import to this is that the two arms of the *Dynex* test are conjunctive. Both must be satisfied. Thus, even if I had found that the parties intended to create and transfer an interest in land, that did not happen.

[95] The second part of the *Dynex* test did not originate from a party purporting to convey a part of an interest to someone else before acquiring the underlying interest itself. In *Dynex*, Major, J was speaking of the fact that the grantor's interest must itself be an interest in land. It was a comment on the *nature* of the grantor's interest; that a grantor cannot create an interest in land from something that was never an interest in land e.g. a contractual right. It was not, at least not in *Dynex*, about the *timing* of acquiring that interest.

[96] In most post-*Dynex* cases, the question posed has been only whether the grantor's interest was fairly characterized as an interest in land or not. However, Vandergrift does address a timing issue similar to the case at bar. In the 1989 case of *Vandergrift*, Virtue J said the royalty interest in that case was not an interest in land because it was expressed as an interest in petroleum substances produced from the land not within the land; *Vandergrift* at para.40. That reasoning was disavowed later by the Supreme Court of Canada in *Dynex*.

[97] However, *Vandergrift* is still worth considering for its jurisprudential value on the second arm; did the grantor have an interest in land to alienate? Virtue J also found that the grantor of the royalty had not yet earned its working interest in the leasehold at the time of granting the royalty. Under the subject farmout agreement, the grantor had to drill a well in order to earn its working interest which did not happen until two years later, as explained in these passages:

> When the royalty agreement was entered into, the grantor, Suffolk, had an interest in the farmout agreement from Imperial and it had a natural gas licence from the Crown. At that time, Suffolk, which granted the royalty, did not have a lease and it would not acquire a lease until it earned it by drilling a well.
>
> …
>
> The effect of this was that Suffolk, at the time it granted the royalty, had the right to earn an interest in land by drilling a well, but it had not yet earned it. Suffolk did not acquire the lease until 13th August 1973, that is, more than two years after the royalty agreement was executed.
>
> ….

> The result is that when Suffolk granted the royalty it did not own an interest in land and could not, therefore, "carve out" or convey an interest in land to the plaintiffs.
>
> *Vandergrift v Coseka Resources Ltd*, 1989 CarswellAlta 76 at paras.45, 46 and 49.

[98] In *Vandergrift*, this was fatal to the grantee's argument that it had received an interest in land.

[99] Similarly in *Quest University*, Quest owned lands and had partnered with Southern Star to build residences thereon. Southern Star had a ground lease under this arrangement, which it objected to having vested off in Quest's *CCAA* proceedings. Fitzpatrick J concluded that Quest was not a lessor under s.32(9) *CCCA* because the parties had intended the lease to be valid and effective between them only once construction commenced and the lease became registerable. Those conditions had not yet been satisfied so Southern Star was not a lessee and could be restrained from attempting to register any encumbrance; *Quest University Canada (Re)*, 2020 BCSC 1883 at paras.35-40; leave refused 2020 BCCA 364. While not dealing with a GOR, it is authority for the *nemo dat* principle applied to the conveyance of an interest in real property.

[100] In responding to this argument, NewGrange's Brief says that the signing of the documents "occurred simultaneously". The practice of signing various documents related to one transaction in close succession is not only reality, but it has also been recognized at law. While the argument was not successful in *Gauvin v Irving Oil*, where Irving Oil signed two different and contradictory agreements with Ms. Gauvin and her husband, the "one transaction" principle itself was cited thus:

> Counsel for the defendant cites *Manks v. Whiteley*, [1912] 1 Ch. 735 at 754 (C.A.) (81 L.J.Ch. D. 457), where Lord Moulton held:
>
> [W]here several deeds form part of one transaction and are contemporaneously executed they have the same effect for all purposes such as are relevant to this case as if they were one deed.
>
> *Gauvin v Irving Oil Co Ltd*, 1985 CarswellNB 47, 64 NBR (2d) 306 at paras.10-11.

[101] Clearly the Royalty Agreement and the APA are part of one transaction. But they were not executed contemporaneously. I agree with Myers J:

> As to the argument that "contemporaneously" can mean "in four days," I was presented with no law to suggest that the meaning of a word can be changed to fit a party's position. There is no ambiguity to the meaning of "contemporaneously". Its ordinary and grammatical meaning is "occurring at the same time."
>
> (*Reserve Properties Ltd. v. 2174689 Ontario Inc.* (2015), 43 B.L.R. (5th) 114, 56 R.P.R. (5th) 131, 2015 ONSC 3469, 2015 CarswellOnt 7890 (Ont. S.C.J.) at para. 17.

[102] The Royalty Agreement may have created a contractual right to a royalty once Free Rein was in the position to pay it but it could not create an interest in land. Nor could it create a

contractual right that could later morph into an interest in land, at least not in the absence of any language whatsoever referencing the APA or the subsequent transfer of title.

[103] In this case, the delay in Free Rein acquiring the Asset made no practical difference because the grantor and the grantee were effectively the same party. However, had they not been, the royalties due for the intervening month would have been problematic. Where the grantee has a royalty but the grantor does not have the land, is anything payable? Is the grantor obligated to pay the royalty on production from which it does not receive revenue? Is the grantor obligated to calculate and reserve royalties to pay later, when it does take title to the interest in lands or production?

[104] Parties to a transaction that purport to convey an interest in land from one to the other must be careful to treat that disposition as a disposition of an interest in land, not as a mere contractual right. That means care with the language across all aspects of the transaction, including care in the timing of execution.

[105] The granting of a royalty on October 18, 2018 in respect of an underlying interest not acquired until November 30, 2018 cannot be a true interest in land.

(iv) Conclusion on the NewGrange GOR

[106] I find that the NewGrange GOR is not an interest in land. In my opinion, the treatment of the GOR in the Royalty Agreement, specifically the assignment provision, along with discretion reserved to the royalty payor, rebuts the presumption created by the language of the granting clause (Cl.2(a) Royalty Agreement). However, even if this were not so, NewGrange's argument fails on the principle of *nemo dat quod non habet*, as captured in the second arm of the *Dynex* test. Free Rein had no interest in the subject Crown leases on October 30, 2018 so it could not grant an interest in those lands to another.

(c) Shareholders' GOR

[107] The Shareholders' GOR arose in different circumstances and uses different language. While all the principles of contractual interpretation as canvassed in the relevant jurisprudence is equally applicable to the Shareholders' GOR, the facts are different.

(i) The 2023 Transaction

[108] In early 2023, Free Rein was in financial difficulty and in default of its Invico Loan Agreement. It identified an existing well (100/06-26-051-27W4M) that could be capable of production if recompleted but it lacked the funds to do this. It collected $150,000 from a group of 19 existing shareholders listed on Exhibit "I" to the McCallum Affidavit filed February 15, 2024 and in exchange, granted the Shareholders a GOR on production from that specific well. The GOR was divided among the Shareholders according to their respective shareholdings.

(ii) The Language of the Shareholder Royalty Agreement

[109] The Shareholder GOR is dated March 8, 2023. Clause 2 of the Shareholder Royalty Agreement reads as follows:

> *(a) The Royalty Owner does hereby reserve to itself and the Royalty Payor does hereby grant to Royalty Owner the Overriding Royalty on Petroleum Substances produced from the Royalty Well as described in this Royalty Agreement and based upon the interest of the Royalty Payor as set forth in the attached Schedule "A".*

The Overriding Royalty is intended to be an interest in land in the Royalty Well and to be a covenant running therewith.

(b) The Overriding Royalty will be calculated at the Point of Measurement as follows:

(i) For all Petroleum Substances 5% of the gross monthly production for the first 36 months of production and 2.5% of the gross monthly production thereafter.

[110] The granting language is therefore not the same and not as clear as the NewGrange Royalty Agreement. The Shareholders' interest is not in land or in substances in or produced from the land but in substances produced from a particular well.

[111] The Assignment Clause (Cl.8) is identical to the Assignment Clause in the NewGrange Royalty Agreement (see paragraph 81 above). It therefore suffers from all the same issues arising from the description of a contractual right to the royalty that follows Free Rein as opposed to an obligation attached to the land and owing from whoever takes the assignment of the land/leasehold interest.

[112] In addition, Clause 6 of the Shareholders' Royalty Agreement provides that, in the event of a corporate sale of Free Rein, the overriding royalty would terminate and the Shareholders would receive a cash payment calculated according to a formula in that clause. This is indicative of an interest in the operator, not an interest in the land that would follow the land and not the working interest owner.

[113] Lastly, there was no evidence that the Shareholders' GOR was registered or was even a registerable interest.

(iii)Conclusion on the Shareholder GOR

[114] Neither the language of the Shareholder Royalty Agreement nor the surrounding circumstances of this transaction support a characterization of this as an interest in land.

(d) The "*Dianor*" Discretion

[115] Invico argued that, even if the NewGrange and Shareholders' GORs were interests in land, they could be vested out anyway by the exercise of the court's discretion under the CCAA or by virtue of its inherent discretion; *Third Eye Capital Corporation v Dianor Resources Inc.*, 2019 ONCA 508 (*Dianor #2*).

[116] Given that I have found that neither GOR is a true interest in land but are rather contractual rights held by NewGrange and the Shareholders against Free Rein, there is no need to review the scope of the court's discretion to vest out an interest in land.

5. Conclusion

[117] This Court's discretion to vest out an interest in land comes from statute. In this case, Invico relies on sections 11 and 36 of the *CCAA*.

[118] Neither the NewGrange nor the Shareholders GORs are interests in land. The NewGrange GOR, notwithstanding its granting language did not treat the interest as running with

the land, particularly in view of the assignment clause in the Royalty Agreement. But more importantly, Free Rein did not have the interest from which it purported to carve out the GOR on the date on the Royalty Agreement. For the Shareholder GOR, it did not even purport to be an interest in the land nor was it treated that way in any aspect of the transaction for which evidence was available.

[119] The NewGrange and Shareholder GORs are contractual claims against the debtor. Having considered all the circumstances, including:

- the lengthy sales process which resulted in no other bidder for these assets,
- the possibility of putting these wells back into production again and avoiding a devolution thereof to the Orphan Well Association,
- the possibility of retaining employees and using existing licences,
- the fact that no stakeholders are worse off in this proposal than they would be in a bankruptcy or a non-RVO transaction; and
- the support of the Monitor;

I find that it is appropriate to issue the RVO as proposed by Invico.

Miscellaneous

[120] A stay of proceedings in this matter was extended to April 30, 2024 by consent. If that needs to be revisited, the parties may contact my office or the Commercial Coordinator. If the parties cannot agree on costs or on any ancillary issues with the RVO not addressed herein, they may contact my office.

Heard on the 28th day of February, 2024.
Dated at the City of Calgary, Alberta this 12th day of April, 2024.

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

Appearances:

Robyn Gurofsky and Anthony Mersich
for the Applicant, Invico Diversified Income Limited Partnership,
by its general partner, Invico Diversified Income Managing GP Inc.

Byron W. Nelson
for the Respondent, NewGrange Energy Inc.

Beth P. Younggren
for Purvida Exploration Inc. and 1591195 Alberta Ltd.

Jeffrey Oliver
for the Monitor FTI Consulting Ltd.