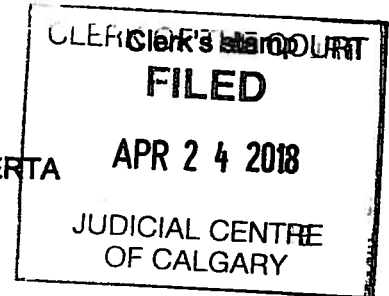


COURT FILE NUMBER 25-2332583
25-2332610
25-2335351

COURT COURT OF QUEEN'S BENCH OF ALBERTA
IN BANKRUPTCY AND INSOLVENCY

JUDICIAL CENTRE CALGARY

PROCEEDINGS IN THE MATTER OF THE NOTICE OF
INTENTION TO MAKE A PROPOSAL OF
MANITOK ENERGY INC.



IN THE MATTER OF THE NOTICE OF
INTENTION TO MAKE A PROPOSAL OF
RAIMOUNT ENERGY CORP.

IN THE MATTER OF THE NOTICE OF
INTENTION TO MAKE A PROPOSAL OF
CORINTHIAN OIL CORP.

APPLICANT FREEHOLD ROYALTIES PARTNERSHIP

RESPONDENT ALVAREZ & MARSAL CANADA INC, IN ITS
CAPACITY AS RECEIVER AND MANAGER
OF MANITOK ENERGY CORP.

DOCUMENT BRIEF OF THE RESPONDENT

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I. INTRODUCTION

1. This Brief is submitted on behalf of Alvarez & Marsal Canada Inc. (**A&M**) in its capacity as the court-appointed receiver and manager (**Receiver**) of Manitok Energy Inc. (**Manitok**).
2. This Brief is submitted in respect of the application by Freehold Royalties Partnership (**Freehold**) pursuant to which this Court has been asked to direct the Receiver to pay a production volume royalty (**Producing Royalty**) to Freehold on the basis that it is an interest in land, among other relief.
3. Manitok and Freehold entered into a Production Volume Royalty Agreement (**Royalty Agreement**) that characterizes the Producing Royalty as an "interest in land" and describes the Producing Royalty as applying to Oil Volumes "within, upon or under" the Royalty Lands. Freehold therefore maintains that the Producing Royalty is an interest in land.
4. While there is some merit to Freehold's position, the Receiver has reasonable doubts as to whether Freehold truly acquired an interest in land from Manitok based on the whole of the Royalty Agreement and how it operates. The Receiver's reasonable doubts are based on the following:
 - "Production Volume Royalty" is defined in the Royalty Agreement as an interest in produced oil.
 - In the event of a default in payment of the Producing Royalty, the Royalty Agreement provides that Freehold may charge interest, set-off amounts that are due or accruing to Manitok, and file legal proceedings for unpaid amounts and interest as liquidated damages. There is no contemplation of any right for Freehold to enter the Royalty Lands to produce them, to lien the Royalty Lands, nor to seize produced oil from Manitok.
 - The Royalty Agreement includes a mechanism to prevent the Producing Royalty from running with the Royalty Lands. The Royalty Lands are to be replaced with substitute properties upon any sale or disposition of the Royalty Lands by Manitok.

- The Producing Royalty diminishes over time and is therefore not truly tied to the duration of Manitok's documents of title.
 - Freehold does not have any right or interest in production from the Wayne Royalty Lands provided there is sufficient production from the Stolberg Royalty Lands. Freehold does not have any right or interest in production from the Carseland Royalty Lands provided there is sufficient production from the Stolberg Royalty Lands or the Wayne Royalty Lands. The Producing Royalty is therefore inherently tied to Manitok's production.
5. The Receiver has concluded, on balance, that an interest in land was not granted to Freehold under the Royalty Agreement. Direction from this Honourable Court is justified, however, given the conflicting interpretations of Freehold and the Receiver.

II. FACTS

A. The Receiver's Appointment

6. Manitok is a public oil and gas exploration and development company.
7. On January 10, 2018, Manitok and its subsidiary, Raimount Energy Corp. (**Raimount**), each filed a Notice of Intention to File a Proposal under Part III, Division I of the *Bankruptcy and Insolvency Act (BIA)*.¹ An additional subsidiary of Manitok, Corinthian Oil Corp. (**Corinthian**), filed a Notice of Intention to File a Proposal on January 19, 2018.²
8. The proposal proceedings of Manitok, Raimount and Corinthian were terminated by court order on February 20, 2018. A&M was substituted in place of FTI Consulting Canada Inc. as the trustee in bankruptcy of Manitok, Raimount and Corinthian. A Receivership Order was also granted on February 20, 2018 pursuant to which A&M was appointed under s. 243(1) of the BIA and s. 13(2) of the *Judicature Act* as the Receiver of all of Manitok and Raimount's current and future assets, undertakings and properties of every nature and kind whatsoever, and wherever situate, including proceeds thereof.³

¹ *Bankruptcy and Insolvency Act*, RSC 1985, c B-3.

² First Report of the Receiver, filed April 24, 2018, at para 2[Receiver's Report].

³ Affidavit of Michael Stone, sworn on April 13, 2018 at Exhibit D (Stone Affidavit); Receiver's Report at para 1.

B. Producing Royalty

9. Freehold is an admittedly sophisticated participant in the oil and gas industry in Alberta. The focus of its business is the acquisition and active management of royalties.⁴
10. Manitok and Freehold negotiated Freehold's acquisition of a production volume royalty.⁵ Freehold has confirmed that it was represented by legal counsel throughout the negotiation process.⁶
11. Manitok and Freehold entered into a Confidentiality Agreement, dated April 6, 2015,⁷ and two non-binding Letters of Intent, dated June 5 and 9, 2015.⁸
12. The Letters of Intent contemplated a cash payment by Freehold to Manitok and the granting of a non-convertible production volume royalty by Manitok to Freehold. The Letters of Intent expressed an intention for Freehold to acquire an interest in land from Manitok,⁹ however, they also contemplated the replacement of the Royalty Lands with substitute properties in the event of a sale or disposition by Manitok.¹⁰
13. The Letters of Intent identified the following as conditions in favour of Freehold, among others:
 - completion by Freehold, to its sole satisfaction, of due diligence on the Royalty Lands;
 - negotiation of a mutually agreeable Production Volume Royalty Agreement and Purchase and Sale Agreement;
 - Manitok's provision of "an Interest Clarification and Acknowledgment Agreement, or similar agreement, in a form acceptable to Freehold... to evidence an agreement among Freehold, Manitok and Manitok's primary lenders, acknowledging the

⁴ Stone Affidavit at paras 6-7.

⁵ Stone Affidavit at paras 13-17; Receiver's Report at para 18.

⁶ Receiver's Report at para 27 and Appendix C.

⁷ Stone Affidavit at Exhibit F. The Confidentiality Agreement is referenced in s 15 of the Letters of Intent.

⁸ Stone Affidavit at Exhibit F.

⁹ Stone Affidavit at Exhibit F (see ss 2(d) and 13(a) of the Letters of Intent).

¹⁰ Stone Affidavit at Exhibit F (see s 13(b) of the Letters of Intent).

interests of Freehold and Manitok with respect to the [Royalty] in the Royalty Lands and the working interest in the Royalty Lands.”¹¹

14. The Letters of Intent evolved from June 5 to June 9 by increasing the amount of Freehold's cash payment from \$15,000,000 to \$25,000,000, adding new Royalty Lands, and expanding a capital expenditure program for the Royalty Lands.¹²
15. Manitok and Freehold entered a Production Volume Royalty Acquisition Agreement (**Acquisition Agreement**) and the Royalty Agreement on June 11, 2015.¹³ An Interest Clarification and Acknowledgment Agreement (**Clarification Agreement**) was entered concurrently by Manitok, Freehold and the National Bank of Canada (NBC).¹⁴
16. In general terms, the Producing Royalty was acquired by Freehold under the Acquisition Agreement, the Producing Royalty and the parties' rights going forward were defined by the Royalty Agreement, and NBC confirmed that it did not have a security interest in the Producing Royalty in the Clarification Agreement.
17. More specifically, the Royalty Agreement provided that:
 - the Producing Royalty was stated to be an interest in land;¹⁵
 - Manitok is estopped “from taking any action whatsoever to dispute, challenge, contest or contend in any manner whatsoever that the Producing Royalty is an interest in land in the Royalty Lands”;¹⁶
 - the Producing Royalty is a “non-convertible production volume royalty” in respect of produced Oil Volumes “within, upon or under” the Royalty Lands;¹⁷
 - for the first eight years from the Effective Date, defined as the Initial Royalty Period, the Producing Royalty would “consist of the first one hundred and forty (140) bbls per day of Oil Volumes produced from” the Royalty Lands;¹⁸

¹¹ Stone Affidavit at Exhibit F (see ss 8 and 9 of the Letters of Intent).

¹² Stone Affidavit at para 9 and Exhibit F.

¹³ Stone Affidavit at Exhibits A (Acquisition Agreement) and B (Royalty Agreement).

¹⁴ Stone Affidavit at Exhibit C.

¹⁵ Stone Affidavit at Exhibit B (see ss 1(ddd) and Schedule B of the Royalty Agreement).

¹⁶ Stone Affidavit at Exhibit B (see Schedule B of the Royalty Agreement).

¹⁷ Stone Affidavit at Exhibit B (see s 1(ddd) of the Royalty Agreement).

- the Royalty would diminish after the Initial Royalty Period by ten percent per year relative to the previous year;¹⁹
- the Royalty would be taken preferentially from Oil Volumes produced from the Stolberg Royalty Lands, failing which the Royalty was "first [to] be taken from produced Oil Volumes from the Wayne Royalty Lands and second from the Carseland Royalty Lands";²⁰
- in default of payment of the Producing Royalty, Freehold could charge interest, set-off against amounts due or accruing to Manitok, and maintain a legal action for unpaid amounts "as if the obligation to pay such amounts and the interest thereon were liquidated damages";²¹
- Manitok would invest in the drilling and recompletion of wells within the Royalty Lands in accordance with a Committed Capital Program²² that would expire on January 1, 2019;²³
- Freehold was authorized to enter the Royalty Lands to remedy any default in Manitok's compliance with the Committed Capital Program²⁴ and would then entitle itself to Manitok's "working interest share of the production of Oil Volumes from the Royalty Lands until the proceeds from the sale of that production equals three hundred percent (300%) of all amounts expended by [Freehold] in the conduct of such operations";²⁵ and
- Manitok would provide Freehold with reasonable prior notice of any intention to sell or dispose of all or any part of the Royalty Lands together with "a description of lands of reasonably similar productive capability that [Manitok] offers to substitute in the place of the disposed of interest in the Royalty Lands" and

¹⁸ Stone Affidavit at Exhibit B (see Schedule B of the Royalty Agreement).

¹⁹ *Ibid.*

²⁰ *Ibid.*

²¹ Stone Affidavit at Exhibit B (see s 7.1 of the Royalty Agreement).

²² Stone Affidavit at Exhibit B (see s 4.2 of the Royalty Agreement).

²³ Stone Affidavit at Exhibit B (see ss 1(i) and 4.2 of the Royalty Agreement).

²⁴ Stone Affidavit at Exhibit B (see s 4.3 of the Royalty Agreement).

²⁵ Stone Affidavit at Exhibit B (see s 4.3 of the Royalty Agreement).

Freehold was prohibited from unreasonably refusing Manitok's offered substitutions.²⁶

18. The Producing Royalty was to be taken from the first 140 bbls of daily production from the Royalty Lands – not a percentage of production – and Freehold was not required to contribute to Manitok's drilling, development or operating costs.
19. The Acquisition Agreement, Royalty Agreement and Clarification Agreement were entered the day immediately prior to the date on which Manitok issued a press release about its acquisition of the Wayne Royalty Lands from Encana Corporation.²⁷ Manitok's press release stated that it had used the proceeds from the sale of the Producing Royalty to fund the purchase price.²⁸
20. The Royalty was paid or taken in kind by Manitok monthly until the date of Manitok's bankruptcy and the Receiver's appointment on February 20, 2018.
21. The Receiver, through legal counsel, asked Freehold to confirm that Manitok was never served with a Deficiency Notice (default under the Committed Capital Program) or a Grantor Default Notice (default in payment of the Producing Royalty) under Sections 4.3(b) or 7.1 of the Royalty Agreement, respectively. Freehold's legal counsel advised in response that Freehold had corresponded with Manitok about the Committed Capital Program in the past. The Receiver has reviewed Freehold's correspondence and has confirmed that none of it took the form of a Deficiency Notice (nor any other form of default notice) under Section 4.3(b). Freehold's legal counsel provided no information to suggest that Manitok had ever defaulted in paying the Producing Royalty or that Freehold had ever served Manitok with a Grantor Default Notice under Section 7.1.²⁹
22. The Producing Royalty was paid by Manitok in money through to the end of August 2017. Freehold served Manitok with a notice to take the Producing Royalty in-kind on August 30, 2017 and the producing royalty was thereafter taken by Freehold in-kind until the marketing of the produced Oil Volumes from February 2018.³⁰

²⁶ Stone Affidavit at Exhibit B (see s 9.1(d) of the Royalty Agreement).

²⁷ Stone Affidavit at Exhibit I.

²⁸ *Ibid.*

²⁹ Receiver's Report at paras 25 and 27 and Appendix C.

³⁰ Stone Affidavit at para 39 and Exhibit O; Receiver's Report at para 24.

23. Former management expressed doubts to the Receiver about whether the Producing Royalty was truly an interest in land, which prompted the Receiver to investigate that issue.³¹ The Receiver thereafter concluded, on balance, that the Producing Royalty is not an interest in land. It advised Freehold accordingly and declined to allocate production to Freehold or otherwise pay the Producing Royalty based on produced Oil Volumes from February 2018.³² Proceeds of production are being held by the Receiver to pay the Producing Royalty to Freehold, if required based on the outcome of this Application.³³
24. Whether the Producing Royalty is an interest in land is significant to the marketability of the Royalty Lands.³⁴ Not only would it significantly reduce the sale price, but it ties the Stolberg Royalty Lands, Wayne Royalty Lands and Carseland Royalty Lands together, which will make it very difficult to sell those assets separately.

III. ISSUES

25. Two issues are addressed in this Brief:
- (1) Is the Producing Royalty an interest in land?
 - (2) What is the appropriate remedy?

IV. ANALYSIS

A. Is the Producing Royalty an interest in land?

26. An interest in land is what it sounds like. It is a property right in the land itself, as distinct from a property right to produced oil or a contractual right to revenues.³⁵
27. Whether a royalty is an interest in land is determined based on a two-part 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.

³¹ Receiver's Report at para 31.

³² *Ibid* at paras 33-34.

³³ *Ibid* at para 34.

³⁴ *Ibid* at para 38.

³⁵ *Vanguard Petroleum Ltd v Vermont Oil & Gas Ltd* (1977), 4 AR 251, 72 DLR (3d) 734 (QB) at para 28 (*Vanguard Petroleum*) [Tab 1].

Virtue J. in *Vandergrift* [(1989), 67 Alta. L.R. (2d) 17 (QB)] at p. 26, succinctly stated:

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.³⁶
28. The second part of the two-part test is not disputed.³⁷ Manitok holds an interest in the Royalty Lands in the form of a *profit à prendre*.
29. The first part of the two-part test is not clear cut.
30. What was "intended" by the parties must be evaluated by considering the whole of their agreement.³⁸ No one term of a royalty agreement is conclusive proof of an intention to convey an interest in land. The determination must be made by "examin[ing] the parties' intentions from the agreement as a whole, along with the surrounding circumstances, as opposed to searching for some magic words."³⁹ The "substance of the transaction" is what matters.⁴⁰
31. Intention is to be evaluated by looking beyond the labels that were used by the parties. A royalty is not an "interest in land" merely because the parties may have used that terminology.
32. The issue in *Vandergrift* was whether an interest in land was granted by a royalty agreement that stated, in part:

2. GROSS OVERRIDING ROYALTY

³⁶ *Bank of Montreal v Dynex Petroleum Ltd*, [2002] 1 SCR 146 at paras 21-22 (Dynex SCC) [Tab 4 of the Applicant's Authorities].

³⁷ The Receiver agrees with paras 25-26 of the Freehold Brief, filed April 10, 2018 (the Freehold Brief).

³⁸ *Creston Moly Corp v Sattva Capital Corp*, 2014 SCC 53 at para 47 (Sattva) [Tab 5 of the Applicant's Authorities].

³⁹ *Scurry-Rainbow Oil Ltd v Galloway Estate* (1993), 138 AR 321, [1993] 4 WWR 454 at para 59 (*Scurry-Rainbow*) [Tab 3 of the Applicant's Authorities]; see also *Bank of Montreal v Dynex Petroleum Ltd*, 1999 ABCA 363 at para 73 (*Dynex CA*) [Tab 2 of the Applicant's Authorities], *James H Meek Trust v San Juan Resources Inc*, 2003 ABQB 1053 at para 35 (*San Juan Resources*) [Tab 2]; and *Third Eye Capital Corporation v Dianor Resources Inc*, 2018 ONCA 253 at para 54 (*Dianor Resources*) [Tab 1 of the Applicant's Authorities].

⁴⁰ *Scurry-Rainbow* at para 45.

The Grantor does hereby grant and assign to the Royalty Owners a Three (3%) percent gross overriding royalty out of the 94.4% interest of the Grantor in all petroleum substances found within, upon or under the lands...

[...]

15. MISCELLANEOUS PROVISIONS

(a) All terms and conditions of this Agreement shall run with and be binding upon the lands.⁴¹

33. Justice Virtue, upon reading the subject royalty agreement as a whole, interpreted it as having conveyed an entitlement to payment based on production.⁴² The "within, upon or under" language was not determinative. Nor was it determinative that a term of the royalty agreement stated that it would run with the subject lands. Justice Virtue's interpretation focused on the whole of the royalty agreement and how it operated.

34. In *Anglo Pacific Group*, the Court of Appeal of Quebec held that a royalty holder did not have a right of ownership in a mining property under the Civil Code even though the parties' royalty agreement stated that it would "create a direct real property interest in the Products and Properties..." The parties' bald characterization of the royalty was not determinative:

The creation of an innominate real right is not solely the result of the use of these terms in a contract. In addition, the contract must contain the essential characteristics of a real right.⁴³ [...]

35. Recent decisions from the United States District Court, Southern District of New York in the Chapter 11 Bankruptcy of Sabine Oil & Gas Corp. (*Sabine*) are also illustrative. Sabine had entered four gathering services agreements, all of which purported to run with the subject lands. Judge Chapman issued a non-binding decision wherein she declined to give effect to the parties' terminology and instead focused on the substance of the agreements: "Under Texas law, language in a contract containing a covenant is the primary evidence of the parties' intent, but terminology is not dispositive" (emphasis added).⁴⁴ Judge Chapman went on to hold that the gathering agreements had not

⁴¹ *Vandergrift v Coseka Resources Ltd.* (1989), 95 AR 372, 67 Alta LR (2d) 17 (QB) at para 35 (*Vandergrift*) [Tab 3].

⁴² *Ibid* at paras 38-39.

⁴³ *Anglo Pacific Group PLC v Ernst & Young Inc.*, [2013] RJQ 1264 (CA) at para 77 [Tab 4].

⁴⁴ *Re Sabine Oil & Gas Corp* (2016), 547 BR 66 at p 8 (US Dist Ct, SDNY) [Tab 5].

transferred any interests in land to Sabine's counter-parties.⁴⁶ Judge Rakoff agreed in a subsequent binding decision.⁴⁶

36. Labels and bald characterizations are not determinative of an agreement's meaning or effect. That is why adding a term that describes an agreement as an "eligible financial contract" does not make it so:

The appellants submit that their contracts are EFCs within s. 11.1(1) of the CCAA as interpreted by Fruman J.A. in *Blue Range*, [(1999), 245 AR 172]. I disagree. The contracts in issue before Fruman J.A. served a financial purpose unrelated to the physical settlement of the contracts. The reasons in *Blue Range* indicate that the contracts Fruman J.A. examined enabled the parties to manage the risk of a commodity that fluctuated in price by allowing the counterparty to terminate the agreement in the event of an assignment in bankruptcy or a CCAA proceeding, to offset or net its obligations under the contracts to determine the value of the amount of the commodity yet to be delivered in the future, and to re-hedge its position. Unlike the contracts found to be EFCs in *Blue Range*, *supra*, the contracts in issue here possess none of these hallmarks and cannot be characterized as EFCs. However, mere *pro forma* insertion of such terms into a contract will not result in its automatic characterization as an EFC. Regard must be had to the contract as a whole to determine its character.⁴⁷

[Emphasis added]

37. That Manitok and Freehold labelled the Producing Royalty as an interest in land in the Royalty Agreement is only some evidence of what they intended. The whole of the Royalty Agreement and how it operates must be considered.
38. The jurisprudence recognizes that various factors are relevant to the determination of whether a royalty is an interest in land, no one of which is conclusive. The factors include the language of the grant,⁴⁸ whether the royalty holder has a right to enter the

⁴⁵ *Ibid* at p 10.S

⁴⁶ *Re Sabine Oil & Gas Corp* (2017), 567 BR 869 at p 6 (US Dist Ct, SDNY) [Tab 6].

⁴⁷ *Re Androscoggin Energy LLC* (2005), 195 OAC 51 at para 15 [Tab 7]; see also *Re Calpine Canada Energy Limited*, 2006 ABQB 153 at paras 17-18 [Tab 8].

⁴⁸ *Dynex CA* at para 84; *Bank of Montreal v Dynex*, 2003 ABQB 243 at para 20 (*Dynex QB*) [Tab 9]. *Dynex CA* was appealed to the Supreme Court of Canada in *Dynex SCC*. That Court affirmed the decision from the Court of Appeal of Alberta, which had remitted the "interest in land" issue to trial. *Dynex QB* is the trial decision that resulted.

lands to engage in production,⁴⁹ whether there is a right to lien the produced lands,⁵⁰ and whether the royalty will last for the duration of the underlying estate.⁵¹

39. The following aspects of the Royalty Agreement are, in the Recelver's respectful submission, relevant to the determination of whether the Producing Royalty is an interest in land:

- "Production Volume Royalty" is defined as an interest in produced oil;
- in the event of a default in Manitok's payment of the Producing Royalty, Freehold has no right to enter or produce from the Royalty Lands, to lien the Royalty Lands, nor to enforce against the produced oil;
- the Producing Royalty does not run with the Royalty Lands because the Royalty Lands are to be replaced with substitute properties in advance of any sale or disposition by Manitok;
- the Producing Royalty diminishes over time so it is not truly tied to the duration of Manitok's underlying estate; and
- Manitok's production is determinative of what Royalty Lands are subject to the Producing Royalty.

40. These aspects of the Royalty Agreement are analyzed below.

"Production Volume Royalty" is defined as an interest in produced oil

41. Section 2.1 of the Royalty Agreement states: "The Producing Royalty is hereby granted by Grantor [Manitok] to Grantee [Freehold]."

42. Producing Royalty is defined in Section 1(ddd) of the Royalty Agreement:

"Producing Royalty" means the non-convertible production volume royalty, being an interest in land, granted by Grantor to Grantee in

⁴⁹ Vandergrift at para 38; San Juan Resources at para 39; Re Walter Energy Canada Holdings, Inc, 2016 BCSC 1748 at paras 66, 67(b) (Walter Energy) [Tab 10].

⁵⁰ Dynex CA at para 85; Dynex QB at para 20.

⁵¹ Dynex CA at para 84; Dynex QB at para 20.

accordance with Clause 2.1 of this Agreement and as set out and described in Schedule "B" of this Agreement.

43. What was granted by Manitoak to Freehold was not a simple "royalty" but was instead a "production volume royalty" – which is suggestive of a royalty in the "production" as distinct from an interest in the Royalty Lands. "Production" is a reference to the oil that is severed from the Royalty Lands.

44. Schedule B of the Royalty Agreement states, in part:

Grant: In accordance with Section 2.1 and this Schedule "B", the Producing Royalty is granted by Grantor to Grantee in respect of all Oil Volumes within, upon or under the Royalty Lands. [...]

45. Neither Section 2.1 nor Schedule B use strong conveyancing language akin to what was used to convey an interest in land in *Scurry-Rainbow*. Section 2.1 and Schedule B do not say that Manitoak was conveying its "estate, right, title, [and] interest" in a portion of the Royalty Lands to Freehold.⁵²

46. The reference in Schedule B to "within, upon or under the Royalty Lands" is suggestive of an interest in land, however, Oil Volumes is defined in Section 1(vv) by reference to production from the Royalty Lands, as follows:

"Oil Volumes" means Crude Oil and Condensate produced from the Royalty Lands, but for certainty excludes any Third Party Production.

[Emphasis added]

47. The definition of Oil Volumes in Section 1(vv) in the Royalty Agreement stands in marked contrast to the definition of Petroleum Substances in Section 1(bbb). Only the latter is inclusive of hydrocarbons that are both in and produced from the Royalty Lands:

"Petroleum Substances" means Crude Oil, Condensate, Natural Gas (including Natural Gas liquids) and every other mineral or substance, or any of them, in and produced from the Royalty Lands.⁵³

48. Indeed, both of the Letters of Intent between Manitoak and Freehold, which preceded the Royalty Agreement, contemplated a royalty in "the petroleum substances within and under the Royalty Lands" (emphasis added).⁵⁴

⁵² *Scurry-Rainbow* at paras 48, 88. See also *San Juan Resources* at paras 41, 45.

⁵³ Stone Affidavit at Exhibit B (see Royalty Agreement at s 1(bbb)).

49. There is tension within Schedule B. On one hand, Schedule B defines the Producing Royalty based on what is "within, upon or under" the Royalty Lands. On the other hand, Schedule B defines the Producing Royalty by reference to Oil Volumes that are "produced from" the Royalty Lands.
50. The Supreme Court of Canada addressed a similar tension in *St. Lawrence Petroleum*.⁵⁵ There, Clause 10(b) of the subject Farm-Out Agreements purported to assign "an undivided interest in the petroleum and natural gas and related hydrocarbons... within upon or under the said lands" while also describing the Participant's interest as being a "percentage of net proceeds of production". The Court refused to identify an interest in land.⁵⁶
51. The linkage of the Producing Royalty to "Crude Oil and Condensate produced from the Royalty Lands" makes the Producing Royalty akin to other production royalties. Courts have held consistently that a royalty on what is "produced" or "produced, saved and marketed" is not an interest in land.⁵⁷
52. The Receiver therefore interprets Section 2.1 and Schedule B as having not conveyed an interest in the Royalty Lands to Freehold.

Freehold has no right to enter the Royalty Lands nor any remedies in rem upon default

53. The right of a royalty holder to enter the grantor's lands to engage in production (upon default or otherwise) is suggestive of an interest in land.⁵⁸ So too is a royalty holder's right to lien the grantor's lands.⁵⁹
54. The Freehold Brief points to Section 4.3(f)(ii) of the Royalty Agreement as support for the proposition that Freehold has a right to enter the Royalty Lands and engage in production "in certain circumstances".⁶⁰

⁵⁴ Stone Affidavit at Exhibit F at clause 2(d); and Exhibit G.

⁵⁵ *St. Lawrence Petroleum Limited v Bailey Selburn Oil & Gas Ltd.* [1963] SCR 482 (*St. Lawrence Petroleum*) [Tab 11].

⁵⁶ *Ibid* at paras 33-37.

⁵⁷ *Vanguard Petroleum* at para 28; *Dynex QB* at paras 40, 56-58; *Walter Energy* at paras 53-59, 66, 67(e).

⁵⁸ *Vandergrift, San Juan Resources* at para 39.

⁵⁹ Freehold Brief at para 37, citing *Dianor Resources* at paras 62-63 and *Dynex ABCA* at para 85.

⁶⁰ Freehold Brief at para 30.

55. The difficulty with Freehold's argument is that Section 4.3(f)(ii) is only available to remedy a default by Manitok with respect to the Committed Capital Program under Article 4. It is clearly unavailable to remedy a default in Manitok's payment of the Producing Royalty.
56. The Committed Capital Program also has a fixed term under Section 4.2 that expires on January 1, 2019,⁶¹ which means that Freehold has no right to enter the Royalty Lands thereafter. The "circumstances" in which Freehold may enter the Royalty Lands, even for the limited purpose of remedying a default under the Committed Capital Program, are time-limited.
57. Freehold's remedies in the event of a default in Manitok's payment of the Producing Royalty are contemplated in Section 7.1 of the Royalty Agreement. It states that Freehold may:
- charge interest at TD Bank's prime rate plus two percent;⁶²
 - set-off against amounts due or accruing to Manitok;⁶³ and
 - maintain an action for unpaid amounts "as if the obligation to pay such amounts and the interest thereon were liquidated damages".⁶⁴
58. Freehold has no right to produce the Royalty Lands as a means of remedying a default in Manitok's payment of the Producing Royalty. Section 7.1 does not contemplate any remedial rights against the Royalty Lands nor, for that matter, the produced oil. The intention is clearly for Freehold to sue for liquidated damages if the Producing Royalty is not paid.
59. The Freehold Brief cites *Dianor* for the proposition that a royalty holder's right to enter lands and engage in production is immaterial because "[i]t makes business sense that a royalty holder should have a non-operating interest."⁶⁵ That may be true – but only until there is a default in the royalty's payment. A royalty holder with an interest in land

⁶¹ Stone Affidavit at Exhibit B (see ss 1(i) and 4.2 of the Royalty Agreement).

⁶² Stone Affidavit at Exhibit B (see s 7.1(a) of the Royalty Agreement).

⁶³ Stone Affidavit at Exhibit B (see s 7.1(b) of the Royalty Agreement).

⁶⁴ Stone Affidavit at Exhibit B (see s 7.1(c) of the Royalty Agreement).

⁶⁵ Freehold Brief at paras 23-24, citing *Dianor Resources* at para 72.

should be expected to secure for itself a right to enter and produce from the subject lands to remedy a default in payment.

60. In any event, it is not the court's role to classify a royalty as an interest in land because that is what a party says "makes business sense" with the benefit of hindsight. It is instead for the parties to negotiate an agreement that grants an interest in land, or doesn't, based on what "makes business sense" to them at the time.⁶⁶
61. The Freehold Brief also points to Freehold's registration of a security notice as an assertion of a lien by Freehold against Manito's working interest in the Royalty Lands.⁶⁷
62. Freehold's security notice includes the following description of its "security instrument":

Production Volume Royalty Agreement which creates an interest in land and a Royalty Owner's first and prior lien upon the Royalty Payor's (Manito Energy Inc.) working interest in the Royalty Lands, the petroleum substances within, upon or under the Royalty Lands, or produced therefrom and the wells and other equipment thereon to secure the Production Volume Royalty.⁶⁸

63. There are a number of problems with Freehold's security notice:
- a security notice is only registerable in respect of a security interest⁶⁹ – not an interest in land;
 - characterizing the Royalty Agreement as a "security instrument" implies that Freehold took security in Manito's interest in the Royalty Lands – not that Freehold acquired its own interest in the Royalty Lands;
 - the Royalty Agreement says nothing about the registration of a security notice; and
 - the Royalty Agreement says nothing about the creation of a "first and prior lien" (or any lien) in favour of Freehold.
64. In any event, a term in an agreement that authorizes the registration of a caveat is very weak evidence of an intention to convey an interest in land: "Although cl. (3) of the

⁶⁶ *Dynex QB* at para 42.

⁶⁷ Freehold Brief at para 47.

⁶⁸ Stone Affidavit at Exhibit K..

⁶⁹ *Mines and Minerals Act*, RSA 2000, c M-17, s 95(1) [Tab 12].

royalty agreement purports to give the grantee, Vanguard, the right to file and maintain a caveat, the caveat, nevertheless, cannot be maintained if it is not based on something that is an interest in land.⁷⁰ Respectfully, the unilateral registration of a caveat in the absence of a term that authorizes its registration is wholly immaterial. It is only evidence of what one party may have intended.

65. Freehold has no right to remedy a default in ManitoK's payment of the Producing Royalty by producing the Royalty Lands, seizing produced oil, or liening the Royalty Lands. That is a strong indication that Freehold did not acquire an interest in the Royalty Lands from ManitoK.

Substitution of the Royalty Lands upon sale or disposition

66. The Freehold Brief argues that Section 9.1(d) of the Royalty Agreement supports Freehold's characterization of the Producing Royalty as an interest in land.⁷¹ The opposite is true.

67. Section 9.1(d) states, in full:

Notwithstanding any other provision of this Agreement, in the event that Grantor sells or disposes of all or a portion of its interest in the Royalty Lands, it shall provide Grantee with reasonable prior notice of such sale or disposition, and include in such notice a description of lands of reasonably similar productive capability that Grantor offers to substitute in the place of the disposed of interest in the Royalty Lands. Such offer shall not be unreasonably refused by Grantee, in the event the Grantee refuses such offer, within ten (10) days of the delivery of the notice referred to in this Clause 9.1(d)(d) [sic], the dispute resolution provisions set out in Article 14 shall apply.⁷²

68. Section 9.1(d) is not an impediment to ManitoK's right to sell or dispose of the Royalty Lands. It is instead a mechanism to replace the Royalty Lands with substitute properties of equivalent productive capability in advance of any sale or disposition of the Royalty Lands.
69. In other words, Section 9.1(d) operates by preventing the Producing Royalty from running with the Royalty Lands.

⁷⁰ *Vanguard Petroleum* at paras 32-33

⁷¹ Freehold Brief at para 41.

⁷² Stone Affidavit at Exhibit B (see s 9.1(d) of the Royalty Agreement).

70. The language in Section 9.1(d) is imperative. Manitok "shall" make an offer to replace the Royalty Lands with substitute properties in advance of any sale or disposition. Freehold "shall not" refuse Manitok's offer unreasonably. Any dispute about the equivalency of the substituted properties is to be resolved in accordance with a binding dispute resolution process.⁷³
71. Section 9.1(d) also states that it operates "[n]otwithstanding any other provision of this Agreement". The Royalty Agreement's mechanism that replaces the Royalty Lands with substitute properties, in lieu of having the Producing Royalty run with the Royalty Lands, is not to be read down based on the use of the term "interest in land" in Section 1(ddd) and Schedule B.
72. A royalty that is an interest in land would ordinarily restrict any sale of the grantor's underlying land interest or impose an obligation on the grantor to have the royalty assumed by the purchaser.⁷⁴ Those sorts of terms were not included in the Royalty Agreement. Section 9.1(d) was instead drafted as a mechanism to prevent the Producing Royalty from running with the Royalty Lands in the event of a sale or disposition.
73. The parties' common intention in Section 9.1(d) is clearly to tie the Producing Royalty to Manitok's operations and production – not to the Royalty Lands.

The Producing Royalty diminishes

74. Section 3.1 of the Royalty Agreement provides that the Producing Royalty is to be paid over a term:

The term of this Agreement shall commence as of the Effective Date, and shall continue thereafter until such time as the Producing Royalty is paid in full in accordance with Schedule "B" to this Agreement.⁷⁵

75. Under the "Amendment" heading, Schedule B states: "The Producing Royalty shall continue for so long as all or any portion of the Royalty Lands remain subject to the Documents of Title existing on the date hereof..."⁷⁶

⁷³ Stone Affidavit at Exhibit B (see ss 14.1-14.3 of the Royalty Agreement).

⁷⁴ *Walter Energy* at paras 66, 67(g), 69.

⁷⁵ Stone Affidavit at Exhibit B (see s 3.1 of the Royalty Agreement).

76. However, Schedule B also contemplates the diminishment in the Oil Volumes that are subject to the Producing Royalty starting after the eight year-long Initial Royalty Period. The Producing Royalty applies to the first 140 bbls per day of Oil Volumes produced during the Initial Royalty Term but then diminishes by ten percent annually relative to the previous year, ultimately approaching nil.⁷⁷
77. Freehold's argument that "[t]he Producing Royalty runs with the Royalty Lands until the Documents of Title expire"⁷⁸ must therefore be taken with a grain of salt. Whereas the Producing Royalty applies to 140 bbls per day of produced Oil Volumes between Year 1 and Year 8, it applies only to 60.3 bbls per day of produced Oil Volumes in Year 16, 25.9 bbls per day of produced Oil Volumes in Year 24, 11.2 bbls per day of produced Oil Volumes per day in Year 24, and so on.
78. Further, the Royalty Agreement does not grant a reversionary interest in favour of Manitok. Starting in Year 9, there will be "Oil Volumes within, upon or under the Royalty Lands" that were previously – but no longer are – part of the Producing Royalty. Yet there is no mechanism in the Royalty Agreement to convey the delta back to Manitok as the Producing Royalty diminishes. The only explanation is that an interest in land was not conveyed to Freehold in the first place.

Manitok's production is determinative of what Royalty Lands are attached by the Producing Royalty

79. The Producing Royalty does not attach to all of the Royalty Lands equally. It is paid preferentially from the Stolberg Royalty Lands. Production from the Wayne Royalty Lands is not attached provided there is sufficient production from the Stolberg Royalty Lands. Production from the Carseland Royalty Lands is not attached provided there is sufficient production from the Stolberg Royalty Lands or the Wayne Royalty Lands.
80. This hierarchy among the Royalty Lands is reflected under the "Calculation of Producing Royalty" heading in Schedule B:

...provided that where one hundred and forty (140) bbls per day of Oil Volumes are not produced from the Stolberg Royalty Lands, the

⁷⁸ Stone Affidavit at Exhibit B (see Schedule B of the Royalty Agreement).

⁷⁷ *Ibid.*

⁷⁸ Freehold Brief at para 33.

Producing Royalty shall in addition consist of that number of barrels required to make up the one hundred and forty (140) bbls per day of Oil Volumes, which shall first be taken from produced Oil Volumes from the Wayne Royalty Lands and second from the Carseland Royalty Lands;⁷⁹

81. Whether Freehold has any right or interest in the Wayne Royalty Lands is determinable based on what is produced from the Stolberg Royalty Lands. Whether Freehold has any right or interest in the Carseland Royalty Lands is determinable based on what is produced from the Stolberg Royalty Lands and the Wayne Royalty Lands. The hierarchy among the Royalty Lands is a further link between the Producing Royalty and the production of Oil Volumes.
82. Freehold, through legal counsel, has confirmed Freehold's understanding that the Producing Royalty was paid with proceeds of production from the Stolberg Royalty Lands until September 2017, at which time Freehold started to take the Producing Royalty in-kind based on produced Oil Volumes from the Stolberg Royalty Lands.⁸⁰ The Producing Royalty has thus never been paid or taken based on production from the Wayne Royalty Lands or the Carseland Royalty Lands. Freehold has never (and may never) have an entitlement to Oil Volumes from the Wayne Royalty Lands or the Carseland Royalty Lands even though those properties were being produced by Manitok and are now being produced by the Receiver. That Freehold has never had a right to Oil Volumes from Royalty Lands that have been (and are being) produced suggests that the Producing Royalty is not an interest in land.

B. What is the appropriate remedy?

83. Freehold is seeking an order for the following relief:
- (a) declaring that the Producing Royalty is an interest in land;
 - (b) "directing the Receiver immediately reverse the revocation of the take-in-kind right provided for under the Royalty Agreement for all production months going forward and immediately pay to Freehold any Proceeds that it received from the sale of the Oil Volumes since the take-in-kind right was improperly terminated"; and

⁷⁹ Stone Affidavit at Exhibit B (see Schedule B of the Royalty Agreement).
⁸⁰ Receiver's Report at para 29 and Appendix C.

(c) solicitor-client costs.⁸¹

84. Each of these heads of relief is analyzed below.

Declaration

85. The Receiver agrees that declaratory relief is appropriate. If the Producing Royalty is an interest in the Royalty Lands, this Court should make a declaration to that effect. Conversely, if the Producing Royalty is not an interest in land, a declaration to that effect should be made.

Directing the Receiver

86. An order that directs the Receiver to act is a form of mandatory injunction. Freehold has not led evidence to support a mandatory injunction, nor has it applied for one.

87. That said, the Receiver is a court officer. It will abide by any declaration that may be made.

Costs

88. There is an established practice in commercial insolvency applications pursuant to which the parties bear their own costs.

89. Whether the Producing Royalty is an interest in land is not clear cut. The Receiver reviewed the Royalty Agreement as a whole, identified terms that appear to be irreconcilable with the conveyance of an interest in land to Freehold, and ultimately concluded, on balance, that an interest in land was not conveyed to Freehold.

90. Freehold disagreed with the Receiver's interpretation of the Royalty Agreement, which necessitated the filing of an application, either by Freehold or the Receiver. This application was then filed by Freehold.

91. The Receiver's obligation as a court officer to act honestly and in good faith includes a duty to analyze the commercial disputes put to it and litigate them as necessary.⁸²

⁸¹ Application of Freehold, filed April 10, 2018, at para 2.

⁸² *Cox v Crystal Graphite Corp*, 2008 BCSC 38, [2008] BCWLD 1788 at paras 18-19 [Tab 13].

Nothing about these circumstances justifies rebuke or any deviation from the established practice of having the parties bear their own costs.

92. Solicitor-client costs are an exceptional tool to remedy litigation misconduct.⁸³ Freehold's request for solicitor-client costs is wholly inappropriate.

V. CONCLUSION AND RELIEF REQUESTED

93. The Receiver respectfully requests an order dismissing this application by Freehold, declaring that the Producing Royalty is not an interest in land, and directing the parties to bear their own costs.

ALL OF WHICH IS RESPECTFULLY SUBMITTED THIS 24 DAY OF APRIL 2018.

NORTON ROSE FULBRIGHT CANADA LLP



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⁸³ *Cormack v Indergaard*, 2018 ABCA 41 [Tab 14].