

## THE LEGAL CHARACTERIZATION OF OVERRIDING ROYALTY INTERESTS IN OIL AND GAS

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*The question of whether overriding royalties are interests in land or interests in pure personalty, a question which has not been decisively answered by the Canadian courts, forms the core of Mr. Davies' article. The author submits that an overriding royalty can be considered an interest in land only if it can be classified as belonging to one of three categories: a reservation or exception of title to a fraction of the oil and gas in place, or; a profit a prendre in itself, or at least a tenancy in common in a profit a prendre, or; a rent or an interest analogous to a rent. After examining Canadian and American authorities lending support to each of the three categories the author, extending to overriding royalties the principles presently applied by Canadian courts to lessor's royalties, concludes that, despite some conceptual difficulties, policy considerations favor the categorization of overriding royalties as rents or interests analogous to rents. The author submits that such a categorization is necessary in order to extend to overriding royalties the protection afforded interests in land.*

### I. INTRODUCTION

This topic is of concern at the moment in Canada where the courts have not been frequently called upon to pronounce upon the nature of overriding royalty interests. The dearth of home grown authority upon this question may be remedied by looking to the many United States decisions in this area, as no doubt attention will be paid to them by Canadian courts. However, as always in such situations, it is necessary to be wary of external authorities lest they be so intimately related to the peculiar needs of the jurisdictions concerned and of the times in which they were established as to be unsuited to the current needs of Canada. Furthermore, it may be doubted whether the jurisprudence of many of the United States jurisdictions, more liberated from the legalism of English common law judges, will recommend itself to more traditionally minded Canadian judges.

The few reported Canadian decisions upon the legal nature of royalties in general and overriding royalties in particular indicates a division of opinion which has yet to be finally resolved and suggests that Canadian courts may possible not adopt the view of the courts of most United States jurisdictions to the effect that such interests are interests in land. On many of the issues discussed in this paper there is no unanimity amongst the United States jurisdictions. You can pay your money and take your choice. This may prompt Canadian courts to resort to *a priori* reasoning rather than borrow too heavily from the United States.

### II. DEFINITIONS AND GENERAL DISCUSSION

A perusal of United States cases, texts and journals relating to oil and gas law problems reveals that this question is no longer considered of great importance in the United states.<sup>1</sup> It seems clear that the courts

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<sup>1</sup> During the 1920's, 1930's and 1940's journals such as the Texas Law Review, California Law Review, and Southern California Law Review rarely appeared without an article or a case comment on the legal nature of royalties and other oil and gas interests. Courts in some of the States have been called on to pronounce on the legal nature of overriding royalties since the 1940's but not often and they have been satisfied to settle the issue by relying on past authorities from their own or other jurisdictions.

have moved on from the problem of classification to that of interpreting the instruments concerned as commercial instruments. Professor Howard Williams has said that the Courts in the States have moved through the conceptual period in relation to the oil and gas lease generally and now see it as a commercial instrument ". . . more closely related to one dealing with the erection and operation of a great manufacturing plant than to an agreement permitting a person to go upon the land of another to sever and remove seaweed to be utilized as fertilizer."<sup>2</sup> However, it is not so clear that the American courts have satisfactorily resolved the conceptual issue, and, as stated in the introduction to this paper, the question appears still to be open in Canada.

Many of the text and article writers do not, in their treatment of overriding royalties, do more than assert their conclusions as to the legal nature of the interests. For discussion and argument they refer back to their sections on the lessor's royalty.<sup>3</sup> Much of what is said in connection with royalties generally is taken to be applicable to overriding royalties. It is submitted, however, that this is not true of all the features of royalties and especially not of some of those features upon which the United States courts have been prone to base their characterizations of the interests. It is necessary, therefore, to commence with definitions of both the lessor's royalty and the overriding or lessee's royalty.

The lessor's royalty has been defined as ". . . a share of the product or the proceeds therefrom reserved to the owner for permitting another to use the property"<sup>4</sup> and as a ". . . right to receive, either in kind or its equivalent in money, a stipulated fraction of the oil and gas produced and saved from the property covered by the lease, free of all costs of development and production."<sup>5</sup> An overriding royalty interest on the other hand may be defined as a fractional interest (or share) in the gross production of oil and gas, in addition to the usual royalties paid to the lessor.<sup>6</sup> Or more commonly the right to take in kind or in money equivalent a share of oil and gas, reserved in an assignment, part assignment or sublease of an oil and gas lease and payable by the assignee to the assignor.<sup>7</sup> The term is usually given the more restricted meaning of an interest in the form of a given share of gross production carved out of the working interest created by an oil and gas lease.<sup>8</sup> It may be instructive, nevertheless, to consider both the overriding royalty created by the lessee of an oil and gas lease upon his assignment of that lease to another party and the overriding royalty created by such lessee in the form of an out and out grant of a share in production to another party; that is to say, in the first case where B, lessee under an oil and gas lease from A, in which A has reserved a twelve and one-half per cent lessor's royalty, assigns the lease to C and reserves to himself a

<sup>2</sup> Williams, *Comments on Oil and Gas Jurisprudence in Canada and the United States*, (1965) 4 Alta. L. Rev. 189 at 192.

<sup>3</sup> *E.g.* Summers, *Oil and Gas* s. 554 merely states conclusions as to overriding royalties with only a minimum of discussion of opposed views, while in volume 3A, which is devoted to royalties, ss. 572-585 contain discussion as to the nature of royalty interests; Williams and Meyers, 2 *Oil and Gas* s. 418.1; Rae, *Royalty Clauses in Oil and Gas Leases*, (1965) 4 Alta. L. Rev. 323 at 324.

<sup>4</sup> See 3A Summers, *Oil and Gas* s. 572, nn. 10 and 11; *Spoooner v. Minister of National Revenue* [1930] Ex. C.R. 229, [1931] 1 D.L.R. 723; and cases listed by Brown, 16th *Annual Institute on Oil and Gas Law and Taxation* 139, n. 2.

<sup>5</sup> Hardwicke, *Problems Arising Out of Royalty Clauses in Oil and Gas Leases in Texas* (1951) Texas L. Rev. 790 at 790-791; (Texas L. Rev., *Oil and Gas*, 1652 at 1652-3).

<sup>6</sup> 3 Summers, *Oil and Gas* s. 554.

<sup>7</sup> *Id.*

<sup>8</sup> 2 Williams and Meyers, *Oil and Gas* s. 418.

fractional share of say twelve and one-half per cent as an overriding royalty, and in the second case, where B retains the working interest but assigns a fractional royalty to D in return say for financial or other contribution towards the development of the lease. It has been said that whatever the form of creation of a royalty or overriding royalty the intention is always the same—to give to the “royalty owner” a present right to a share in future production.<sup>9</sup> It will be noticed that in some Canadian cases discussed later the courts have taken a different view.<sup>10</sup> However, it would generally be agreed that the interests are not intended to carry with them any right to enter nor any right to produce nor to participate in any way in the management, operation or liabilities of the production enterprise.

The problem of classification or legal characterization of overriding royalties and of royalties generally has persistently raised three questions: (1) Are they interests in land? (2) Are they corporeal or incorporeal interests? (3) Are they real or personal interests?

Before attempting to answer these questions it may be useful to ask to what extent and in what respects it matters whether overrides are interests in land, corporeal or incorporeal, realty or personalty. It seems that the distinction between corporeality and incorporeality is no longer of much importance.<sup>11</sup> It was always a strange distinction for English common lawyers to have drawn anyway, as even the fee simple estate in land could not itself be anything more than incorporeal, an abstraction, being distinct from the land itself as a physical, tangible substance.

It would appear that the distinction between realty and personalty is for the present and the future likely to be of diminishing significance as statutory provisions affecting property interests, such as statutes of frauds provisions, recordation statutes, taxation statutes and so forth, tend to be drawn widely and not to be confined merely to realty but to extend to all interests in land.<sup>12</sup> None of this, however, lessens the significance of the basic distinction between interests in land and interests in pure personalty. That this question is still of importance in Canada is clearly demonstrated by the recent decisions in *St. Lawrence Petroleum Ltd. v. Bailey Selburn Oil*<sup>13</sup> and *Emerald Resources v. Sterling Oil Properties*.<sup>14</sup> It was not necessary for the court in the latter case to give a final decision as to the nature of an overriding royalty but as will be seen later a fairly firm indication of its attitude was given. In the former case the overriding royalty claimants were refused registration of their overriding royalty interest under s. 176(1) of the Mines and Minerals Act,<sup>15</sup> and the protection afforded by registration, such as

<sup>9</sup> Levy, *Oil Royalties—A District Species of Property* (1938) 11 So. Cal. L. Rev. 319.

<sup>10</sup> *St. Lawrence Petroleum Ltd. v. Bailey Selburn Oil* (1963) 45 W.W.R. 26; *Emerald Resources v. Sterling Oil Properties* (1969) 3 D.L.R. (3d) 630.

<sup>11</sup> Williams and Meyers, *Oil and Gas* s. 210. It should be noted, however, that in cases where the divisibility of oil and gas leases has been questioned, courts have held exclusive profits *à prendre* to be corporeal interests and therefore divisible, avoiding the rule against divisibility of incorporeal hereditaments. *Caldwell v. Fulton* (1858) 31 Pa. Pa. 475; *Stanton et al v. Herbert and Sons et al.* (1919) 211 S.W. 353; *Van Rensselaer v. Radcliffe* (1833-34) 10 Wend. (N.Y.) 639; *Mountjoy's Case*, Godbolt 17; *Chandler v. Hart* (1911) 111 P. 516; *New Haven v. Hotchkiss* (1904) 58 A. 753; *Baker v. Kenney* (1910) 24 N.W. 901. However, reasons other than a distinction between corporeality and incorporeality may also be found in those cases for allowing interests in oil and gas leases to be divided.

<sup>12</sup> Williams and Meyers, *Oil and Gas* s. 213; e.g. s. 136 of the Land Titles Act, R.S.A. 1970, c. 198 allows persons to file caveats if claiming to be interested "... otherwise howsoever in any land, mortgage or encumbrance ..." and the Statute of Frauds, R.S.O. 1960, c. 381, s. 1 applies to "... every uncertain interest of, in, to or out of any messuages, lands, tenements or hereditaments." Also the Limitation of Actions Act, R.S.A. 1970, c. 209, s. 2 defines land to include corporeal hereditaments and a freehold estate or an interest therein.

<sup>13</sup> *Supra*, n. 10.

<sup>14</sup> *Id.*

<sup>15</sup> R.S.A. 1970, c. 238.

it is, because the court was of the opinion that the interest they claimed was not an interest in land but pure personalty. Essentially, the court said that the interest created was not a lease, license, reservation, permit or other agreement entered into under the Act, nor an undivided interest in any of the above. Probably the usual form of royalty interest, even if held to be an interest in land, could not be considered an undivided interest in a lease, as it is not possessory. Thus the essential unity, that of possession would be absent as between the working interest holders and the owner of the royalty interest. Furthermore it was denied that the overriding royalty owner had any right to receive and sell any share of production in kind from the lands.

Notwithstanding the earlier remarks with reference to the immateriality of the distinction between corporeality and incorporeality so far as overriding royalties are concerned, the question, if asked, can be readily answered. It is submitted that these interests as created by the usual royalty agreement are clearly incorporeal irrespective of the view taken of the nature of the interest given by an oil and gas lease.<sup>16</sup> They involve the granting of rights in respect of land, rather than of land, the physical object itself. It is acknowledged that the substances once severed are personalty rather than realty. Further, in Canada, since *Berkheiser v. Berkheiser*<sup>17</sup> in which the lease was held to give a *profit à prendre* in gross, an incorporeal hereditament, they must *a fortiori* be incorporeal as they are thus carved out of, or rest upon, an incorporeal hereditament and cannot be any more corporeal in quality than that hereditament.

So far as determining whether overriding royalties are realty or personalty is concerned, again the answer is straightforward. The common law test for determining whether interests in land are real or personal has for many centuries been one of duration. That is to say, the test has really been that for distinguishing between freehold and leasehold. An interest is real property if of uncertain duration, for example, if granted in fee simple and capable of lasting for an indeterminate period or for life, which is of notably uncertain duration. It is personal property or a chattel real if of certain duration. It should be called to mind at this point that a leasehold interest, though a personal interest by that definition, was nevertheless adjudged an interest in land—a chattel real as opposed to pure personalty.<sup>18</sup>

The usual overriding royalty interest is limited to endure as long as the lease upon which it is raised. The usual lease is for a fixed term and thereafter for the producing life of the land. As such it is viewed as analogous to a determinable fee interest.<sup>19</sup> The royalty interest, being of equally uncertain duration, should be equally regarded as a real interest.

If on the other hand the overriding royalty interest is limited to a certain duration, a term of years for example, it must be treated as a personal interest in the nature of a chattel real. A good example of a court reasoning in this fashion is found in *Arrington v. United Royalty Co.*<sup>20</sup>

<sup>16</sup> 1 Williams and Meyers, *Oil and Gas* s. 209; 2 Williams and Meyers, *Oil and Gas* s. 418.1.

<sup>17</sup> [1957] S.C.R. 387.

<sup>18</sup> Megarry and Wade, *Real Property* 11, 43 (3rd ed. 1966).

<sup>19</sup> *Berkheiser v. Berkheiser*, *supra*, n. 16; Lewis and Thompson, *Canadian Oil and Gas* s. 38; Walker, *The Nature of the Property Interests Created By an Oil and Gas Lease in Texas* (1928) 7 Texas L. Rev. 1 at 24-25.

<sup>20</sup> (1933) 65 S.W. (2d) 36.

However, all of this reasoning is predicated on the understanding that the overriding royalty is an interest in land. It remains to determine whether this is so. The distinguished American oil and gas lawyers Professors Williams and Meyers assert that royalties are interests in land because they entitle their owner to share in the proceeds of the exploration and development of land.<sup>21</sup> That may well be a powerful reason for saying that they ought to be treated as such and that perhaps the courts or, if necessary, the legislature should take the bull by the horns and characterize them as incorporeal hereditaments in their own right and define their nature, incidents and limitations independently of existing types of incorporeal hereditament.<sup>22</sup> It does not follow, however, that Williams' and Meyers' statement provides a correct explanation of the approach which the courts have taken towards overriding or other royalties. The tendency has been to relate royalties to recognized types of incorporeal (and in some cases corporeal) interest which puts technical difficulties in the way of treating the fact that royalty interests entitle their owners to share in the proceeds of exploration and development of land as fixing them as interests in land.<sup>23</sup>

Professor Summers' view is that overrides are usually held to be interests in land or real property because they are conveyances or reservations of a part of the lessee's interest which, in most United States jurisdictions and in Canada, is itself real property.<sup>24</sup> But in view of the remarks of the courts in the two cases earlier referred to: *St. Lawrence Petroleum Ltd. v. Bailey Selburn Oil* and *Emerald Resources v. Sterling Oil Properties*,<sup>26</sup> it should be asked whether an overriding royalty is in fact a conveyance of part of the lessee's interest or a reservation from an assignment of his interest as the case may be? Certainly one Canadian writer has formed the conclusion that the Canadian courts have so far been inclined to treat royalties generally as personalty and therefore to deal with them according to the rules of contract rather than the rules of real property.<sup>27</sup>

The above mentioned decisions are necessarily based upon their peculiar fact situations and it may be technically possible to distinguish the overriding royalty interests granted in those cases from the classical form of override. But the reasoning employed may be of wider import than the decisions themselves. It was reasoned that as the lessee has nothing more than a *profit à prendre* himself, he has no title to the oil and gas in place and that, therefore, he cannot convey or create, either by grant or reservation, any interest in them while in place.<sup>28</sup> Further, in the *Emerald* case it was said that as the royalty was calculable and payable upon the products mentioned only after their severance from the land the interest given could only be an interest in personalty.<sup>29</sup>

The question arises as to whether all royalties based on production are not necessarily calculable and payable only after the products them-

<sup>21</sup> 1 *Oil and Gas* s. 212.

<sup>22</sup> See *Levy, supra*, n. 9.

<sup>23</sup> See cases discussed *infra* at

<sup>24</sup> 3 Williams and Meyers, *Oil and Gas* s. 554.

<sup>25</sup> (1963) 41 W.W.R. 210 at 214 (Alta. C.A.).

<sup>26</sup> *Supra*, n. 10 at 642.

<sup>27</sup> McIntyre, *The Development of Oil and Gas Ownership Theory in Canada*, (1969) 4 U.B.C. L. Rev. 245.

<sup>28</sup> *St. Lawrence Petroleum Ltd. v. Bailey Selburn Oil* (1963) 41 W.W.R. 210.

<sup>29</sup> (1969) 3 D.L.R. 630 at 636.

selves have been severed from the land and have become personalty? Of course, they must be. The trend of thought in these two cases would seem, then, to deny that any such royalty may ever be an interest in land.

The validity of the reasoning in these cases warrants close testing. In concentrating upon the manner in which the royalty provisions provided for the calculation and payment of the royalties did the court perhaps take hold of the wrong end of the stick? Is it not the interest for which the payment is made that characterizes the periodic payment made by a lessee to his lessor as rent?<sup>30</sup> Would it be any the less rent if, say in the case of an agricultural lease, it was to be made out of the proceeds of the sale of the agricultural lessee's crops? It is submitted that the answer is that the prescription of payment out of production merely delimits the fund upon which the lessee's obligation to make any payment at all is placed. In the straightforward case of lessor and lessee, whether of oil and gas lands or any other land whatsoever, the payment made if production is obtained remains a payment for the right over the land, which the lessor has granted the lessee. The position would seem to be similar as between the lessee B and his assignee C in the example given earlier.<sup>31</sup> Problems may, however, be posed in the case of certain overrides. For example, where B, the lessee, simply grants an overriding royalty to D in return for financial or other assistance, B has granted no right in the land to D. It may, therefore, be difficult to argue that the right or payment, which D has, is in any way an interest in land. However, before reaching a final conclusion, the authorities and the different theories as to the legal nature of overriding royalties should be examined.

There are a number of theories and the United States authorities are many and diverse. It is proposed therefore to adopt a structure within which to conduct the necessary examination in the hope that confusion may thereby be reduced.

It would seem that an overriding royalty interest can be an interest in land according to the presently accepted traditional categorizations of interests in land only if it is in substance one of the following: (1) a reservation or exception of title to a fraction of the oil and gas in place; (2) a *profit à prendre* in itself, or at least a tenancy in common in a *profit à prendre*; (3) a rent or an interest analogous to a rent.

These categories accord with the views adopted by different courts in the United States at different times. Each of these possibilities will be examined in turn. Use will be made of American authorities but it must be remembered that different views have been adopted in different parts of the States as to ownership of oil and gas in place and this has led to differences in opinion as to the nature of the lessee's interest and royalty interests. Furthermore, as indicated at the commencement of this section of the article, and as just illustrated by the example in which an overriding royalty is granted by the lessee B to an outside party D, not everything that can be said of the lessor's royalty will necessarily apply to all overriding royalties. Many of the authorities to be looked at relate to the former rather than the latter. It will be necessary therefore to take care that relevant differences between the two types of interest are considered.

<sup>30</sup> Or in the case of a rent charge, the thing upon which payment is charged?

<sup>31</sup> *Supra*, at 233.

### III. CANADIAN AUTHORITIES

Before turning to the first three possibilities it may be instructive to look briefly at some views so far pronounced by Canadian courts. In *Re Dawson and Bell*<sup>32</sup> the Ontario Court of Appeal held, for the purpose of determining whether royalty payments under a lease of a tract of land should be apportioned between the owners of the several portions of that tract and not paid only to the owners of those parts containing producing wells, that such royalty payments were compensation for the right to occupy the land and, in essence, rent.<sup>33</sup> In doing so the court followed the English decision *R. v. Westbrook; R. v. Everist*.<sup>34</sup> It rejected the notion that a royalty is the purchase price of a chattel reduced to possession and commented that United States decisions are only useful "... in so far as they may expound the law consistently with the principles of English law."<sup>35</sup> The royalty clause provided that in consideration of the grant and demise the grantee/lessee would give the grantor/lessor one barrel of every ten barrels, or its equivalent in cash, of petroleum obtained or produced on the premises leased.

In *Spooner v. Minister of National Revenue*<sup>36</sup> the Exchequer Court of Canada held a royalty to be a reservation operating as an exception out of the demise of the profits derived from the working and development of the land. Therefore, the court concluded that for taxation purposes the royalty was income and not capital, being in the nature of a rent. It is interesting to note that an old English decision, *The King v. St. Austel*,<sup>37</sup> was cited in support of the finding and that report, though inadequately brief, was to the effect that a royalty operated as an exception out of the demise and therefore was not in the nature of a rent. The relevant clauses in the *Spooner v. M.N.R.* agreement were to the effect that a free of cost royalty of ten per cent of all petroleum, gas and oil produced and saved was reserved in consideration for an agreement to sell all right and title to land and to transfer in fee simple in the event of oil or gas being discovered in commercial quantities.

In 1940 the Exchequer Court in *B. & B. Royalties v. Minister of National Revenue* said, *per* Maclean J., that the term royalty more properly applied to an interest in production reserved by the original lessor by way of rent for the right or privilege of taking oil or gas out of a designated tract of land.<sup>38</sup> In *McCull-Frontenac Oil Co. Ltd. v. Hamilton*<sup>39</sup> Kellock J., speaking for the majority of the Supreme Court of Canada, did refer to certain remarks passed in an English decision, *Re Aldam*,<sup>40</sup> to the effect that the rent reserved in a mineral lease was really purchase money for minerals sold rather than what is normally understood by rent reserved on an ordinary demise of the surface. However, the characterization of a royalty was not essential to the *McCull Frontenac* decision and it would appear that the mineral leases

<sup>32</sup> [1945] O.R. 825.

<sup>33</sup> *Id.* at 826.

<sup>34</sup> (1847) 10 Q.B. 178.

<sup>35</sup> *Supra*, n. 31 at 831.

<sup>36</sup> [1930] Ex. C.R. 229.

<sup>37</sup> 5 B. & A. 693, 106 E.R. 1344.

<sup>38</sup> [1940] Ex. C.R. 90 at 92.

<sup>39</sup> [1953] 1 S.C.R. 127, [1953] 1 D.L.R. 721.

<sup>40</sup> [1902] 2 Ch. 46 at 56, 58 and 63.

in *Re Aldam* and like cases<sup>41</sup> were construed as grants of the minerals as land. As noted earlier, the Supreme Court of Canada, in *Berkheiser v. Berkheiser*,<sup>42</sup> has held the usual oil and gas lease to be a *profit à prendre* rather than a grant of minerals as such, and in that case, Rand J. said that the rents and royalties provided for under an oil and gas lease were profits and, like rents from a leasehold, were embraced in a devise of the land over which the oil and gas lease had been given.<sup>43</sup> However, it should be noted that in *Hayduk v. Waterton*<sup>44</sup> the Supreme Court of Canada accepted the view that a life tenant would not ordinarily be entitled to royalties, seemingly on the ground that such receipts are capital and not income. In doing this the Court agreed both with the trial judge and the Appellate Division of the Supreme Court of Alberta. It should be noted, however, that the position of a life tenant with respect to minerals has always depended upon two factors: (1) whether he is impeachable for waste and (2) whether or not the mine was open when his tenancy began.<sup>45</sup> The differences of view evidenced in these above cases may simply be an illustration of the fact that for different purposes rights may take on different aspects and consequences.

More recently in *Bensette v. Reece*,<sup>46</sup> Disbery J. of the Saskatchewan Queen's Bench said that a royalty is a fractional interest in the production of oil and gas created by the owner either by reservation or by direct grant to a third person. Further that where the words "give, grant, bargain, sell, assign and transfer" were used a fractional interest in the minerals in the land was conveyed. Thus interests in land capable of being protected by caveat under the Land Titles Act of Saskatchewan<sup>47</sup> were created. The judge's reasoning in this case is not particularly clear, as he speaks of royalties in general terms, but the particular instrument with which he was concerned was very different from the usual royalty agreement. Furthermore, he relied on *Re Publix Oil and Gas Ltd.; Re Canadian Credit Men's Trust Association Limited and Merland Oil Co. of Canada*<sup>48</sup> for support for the proposition that a royalty is an interest in land. In that case it was not clear whether the court regarded a royalty interest as an interest in land or an interest in a chattel. The distinction did not matter because, even if a sale of a royalty was regarded as a sale of a chattel, section 5 of the Bills of Sale Act<sup>49</sup> would, in the circumstances, have produced the same result in that case as would have flowed from treating a royalty as an interest in land. However, the grantor in *Bensette v. Reece* was a freehold owner and did use words appropriate to the granting of a real interest in land.

More recently still in *Keyes v. Saskatchewan Minerals*,<sup>50</sup> Maguire J. speaking for the Saskatchewan Court of Appeal said that the term "royalty" could be used in different senses. In one sense to indicate a

<sup>41</sup> *Gowan v. Christie* L.R. 2 Sc. & Div. 273; *Joggins Coal Co. v. M.N.R.* [1950] 3 D.L.R. 1, [1950] S.C.R. 470.

<sup>42</sup> *Supra*, n. 16.

<sup>43</sup> *Id.*

<sup>44</sup> (1968) 64 W.W.R. 641 at 652.

<sup>45</sup> *Megarry and Wade, supra*, n. 17.

<sup>46</sup> (1969) 70 W.W.R. 705.

<sup>47</sup> R.S.S. 1965, c. 115, s. 150.

<sup>48</sup> (1936) 3 W.W.R. 634.

<sup>49</sup> R.S.A. 1970, c. 29.

<sup>50</sup> (1970) 12 D.L.R. (3d) 637.



basis for computing compensation for consideration given, thus establishing a contractual right, but more commonly to indicate a reservation by the owner of land with mineral rights on the granting of a "lease" or right to search for and remove minerals. The court held that when so used the royalty binds assignees of the lessee as well as the lessee himself. The relevant clauses in that case provided for a royalty of twenty-five cents per ton on sulphur produced and sold and a base production royalty of one per cent on oil and gas won.

Finally in *Harrington and Bibler Ltd. v. M.N.R.*<sup>51</sup> the Tax Board offered a "... good and concise" definition of a royalty; viz., "... a payment, measured by production, for the temporary or complete cession of some right or interest in property."

All of these cases concerned lessor's royalty. The only Canadian cases relating to overriding royalties are *St. Lawrence Petroleum* and *Emerald Resources* mentioned before. In the former case, *St. Lawrence Petroleum Ltd.* was entitled, under an agreement assigned to *Bailey Selburn Oil*, to receive twenty per cent of the net proceeds of production from a test well it agreed to drill. Net proceeds of production were defined as the proceeds from the sale of the *Bailey Selburn Company's* share of the production from that well less certain specified deductions. *St. Lawrence* was thus entitled to a twenty per cent share of the *Company's* share of proceeds from the sale of production after specified deductions had been made from that share. So far there is nothing in express words to indicate that an interest in land was being given in any way, shape or form. However, a later clause purported to assign to *St. Lawrence Petroleum*:

... such an undivided interest in the petroleum and natural gas etc. . . . within upon or under the said lands as will upon . . . the production therefrom being sold all as in this Agreement provided yield to the Participant the percentage of net proceeds of production as herein defined [i.e. twenty per cent].

That clause went on to say "... the *Company [Bailey Selburn]* agrees to hold its interest in the said petroleum etc. . . . in trust for the purpose of this Agreement."<sup>52</sup>

The Supreme Court of Canada held that however the interest created by the clause was defined it was only equitable in the light of the agreement to hold in trust and therefore not such an interest as to be capable of assignment by itself, according to s. 176(1) of the *Mines and Minerals Act*.<sup>53</sup>

The Appellate Division of the Supreme Court of Alberta, from whence the appeal had been taken, was perhaps a little clearer in its reasoning in pointing out that the clause purported to assign an interest in "petroleum gas and related hydrocarbons" and not any interest in the *Bailey Selburn Company's* interest under the oil and gas lease.<sup>54</sup> Thus, as that interest was to be regarded as a *profit à prendre* in view of *Berkeiser v. Berkheiser*,<sup>55</sup> the *Bailey Selburn Company* had no interest in the petroleum substances in place and could give no such interest. The only interest it could give in the named substances was an interest

<sup>51</sup> (1967) 21 D.T.C. 1.

<sup>52</sup> (1963) 45 W.W.R. 26.

<sup>53</sup> R.S.A. 1970, c. 238.

<sup>54</sup> (1962) 41 W.W.R. 210.

<sup>55</sup> *Supra*, n. 16.

in them as chattels once reduced into possession. Thus no interest in land was created.

It should be noted that this was not a case in which anyone was expressly granted an "overriding royalty" which was then defined as to quantity by reference to a fractional share of production or fractional share of the proceeds of sale of production. What was apparently granted was simply a fractional share of the proceeds of sale of production (less certain deductions) without any reference to there being an interest in land underlying this except for the abortive attempt to grant an undivided interest in substances in which the grantors had no interest while they were in and part of the land. This raises the question whether, in view of the definition of overriding royalty given at the outset,<sup>56</sup> a provision giving a fractional share of the proceeds of production to be paid out of the lessee's working interest share is by definition an "overriding royalty" notwithstanding the fact that no mention is made of that term. If it is, it will attract all the incidents of a royalty despite the failure to expressly term it a royalty interest. Further consideration of the question will be postponed until the conclusion of the paper.

It was stated earlier that the court did not reach a final conclusion on the nature of the royalty interest involved in *Emerald Resources v. Sterling Oil Properties*.<sup>57</sup> However, it was clear that the court's inclination was to regard the interest as pure personalty. The respondent had claimed an "overriding royalty of one-half of one per cent on properties in which the appellant should acquire an overriding royalty." The appellant had acquired certain gross overriding royalties of two per cent of its grantor's share of all petroleum *etc.*, produced, saved and sold from certain properties. Thus the respondent was claiming an interest to the value of twenty-five per cent of the gross overriding royalties obtained by the appellants.

Allen J.A. doubted whether the respondent's interest was an interest in land, indeed he doubted that the appellant's overriding royalty interests out of which the respondent's interest was carved were interests in land. His Lordship quoted the terms of the appellant's interests "a gross overriding royalty of two per cent (2%) of High Crest's share of all petroleum, natural gas and related hydrocarbons produced, saved and sold. . . ." He then continued: "this clearly indicates that the royalty is to be calculated and payable only upon the products mentioned after they have been taken from the ground and severed from realty." This suggested that the appellant's interest, let alone the respondent's interest, was "personalty and not land or an interest therein."<sup>58</sup> It was not necessary, however, for His Lordship to reach a firm conclusion in view of the other circumstances of the case.

#### IV. UNITED STATES AUTHORITIES AND THEIR CORRELATION WITH CANADIAN CASES

United States decisions will now be looked at under headings appropriate to the three possible categorizations of royalty interests referred to earlier.<sup>59</sup>

<sup>56</sup> *Supra* at 233.

<sup>57</sup> *Supra* at 234.

<sup>58</sup> (1969) 3 D.L.R. (3d) 630 at 636.

<sup>59</sup> *Supra* at 234.

1. *The overriding royalty as a reservation or exception of title to a fraction of the oil and gas in place .*

In *Hager v. Stakes*<sup>60</sup> and *Sheffield v. Hogg*<sup>61</sup> the Supreme Court of Texas held that a provision in a lease for the payment to the lessor of royalty in kind operates as an exception or reservation of the specified fraction of the oil from the grant. Thus the lessor retains fee simple title to that portion of the oil in place. Further in *Sheffield v. Hogg* it was laid down that this was so regardless of the precise language used in the royalty clause. Greenwood J. said:<sup>62</sup>

It logically can make no difference, as may have been intimated in this justice's and in other far greater jurists' reasoning, whether the oil is retained by the lessor as oil and gas, readily convertible into cash on the market, or whether the lessee is given a power to sell *all* of the oil and gas, always accounting for a fixed royalty portion to the lessor..

First, with respect to the application of these decisions to Canada, it should be noted that they rest upon the following concepts; (1) ownership of the oil and gas *in situ* in the first place, (2) treatment of the lease as granting to the lessee title to the oil and gas in place except for the royalty portion and (3) treatment of the royalty clause as a reservation of title to a portion of the oil and gas in place.

It has not yet been conclusively determined in Canada whether or not the fee simple owner of land not subject to reservation of oil and gas owns the oil and gas *in situ*. This was assumed for the purposes of the decision in *Borys v. C.P.R.*,<sup>63</sup> and support for this proposition is found in the earlier cases, *Re Registration of a Transfer of Coal Rights*<sup>64</sup> and *Landowners Mutual Minerals Ltd. v. Registrar of Titles*,<sup>65</sup> but it is not certain that the same view would be taken if the question arose for direct determination.<sup>66</sup>

Even if that view is adopted it may not carry the argument much further in Canada, at least in Western Canada, where the Crown has retained ownership rights in mineral substances in most of the land.<sup>67</sup> The area for the practical application of the theory is thereby considerably reduced and the remaining steps in the reasoning in *Sheffield v. Hogg* seem inapplicable as ordinary oil and gas leases are not taken as conveying any title to the oil and gas in place to the lessee. Thus, even where the oil and gas may be owned in place by an individual freeholder, the granting by him of a working interest to a "lessee" will not, if effected in the usual form, convey anything more than a *profit à prendre*. It may be possible, however, for him to grant away title to the substance in place if he wishes by appropriate words to create a mineral fee estate.<sup>68</sup> However, even if this is done it is submitted that the Canadian courts are likely to insist on the use of very clear words of granting appropriate to the creation or disposition of an interest in land

<sup>60</sup> (1927) 294 S.W. 835.

<sup>61</sup> (1934) 77 S.W. (2d) 1021.

<sup>62</sup> *Id.*

<sup>63</sup> (1953) 7 W.W.R. 546.

<sup>64</sup> [1914] 7 W.W.R. 769.

<sup>65</sup> (1952) 6 W.W.R. 230.

<sup>66</sup> McIntyre, *supra*, n. 26.

<sup>67</sup> Except in so far as royalties reserved by the Crown are concerned. This would not help in categorizing overriding royalties.

<sup>68</sup> *Berkheiser v. Berkheiser*, *supra*, n. 16, per Kellock J., applied in *Bensette v. Reece*, *supra*, n. 45.

in the form of the minerals in place. The form of words used in the clause reviewed in *Bensette v. Reece*<sup>69</sup> should be studied.

So much for lessor's royalties. In view of the characterization of ordinary oil and gas leases in Canada as *profits à prendre* the Texas reasoning on royalties appears inapplicable to overriding royalties. Indeed, even in Texas, while the courts hold overriding royalties to be interests in land they do not do so on the ground that the instruments convey title to the oil in place even where the royalty is to be paid in kind. This is made quite clear in *Tennant v. Dunn* where it was acknowledged that the overriding royalty owner had no interest in the oil and gas in place yet it was held that the royalty was an interest in land.<sup>70</sup> Perhaps it may be remarked that the reasoning in royalty and overriding royalty cases seems somewhat inconsistent, though the court in *Tennant v. Dunn* saw the important point in the *Sheffield v. Hogg* decision as being the holding that royalties were interests in land because they were profits arising out of the land rather than the three points referred to relating to the concept of ownership in place.

## 2. The overriding royalty as a *profit à prendre* or as a tenancy in a *profit à prendre*.

It hardly seems likely that any of the more common overriding royalty provisions could be so interpreted as to give rise to a *profit à prendre* in the royalty owner. Royalty agreements usually make it quite clear that the royalty owner has no operating rights nor even any right to enter upon the land for the purposes of exploration or drilling. His interest is, whether an interest in land or not, one which entitles him to share in production or the proceeds of sale thereof. It is not a participating interest. Therefore, it carries no right to execute oil and gas leases<sup>71</sup> nor any right to explore and develop.<sup>72</sup>

The possibility that royalties generally may be treated as *profits à prendre* was raised by Adolph H. Levy of the Los Angeles, California, Bar in 1938.<sup>73</sup> He was quick to strike down the possibility and was critical of certain Californian cases which he asserted had held landowner's royalties<sup>74</sup> to be *profits à prendre*. The cases relied on by Levy are *Callahan v. Martin*<sup>75</sup> and *Dabney-Johnston Oil Corporation v. Walden*.<sup>76</sup> These cases did so treat interests created by the landowner which the courts found to be intended to endure in perpetuity and not to be tied to any particular lease. The courts may well be open to criticism both on the legal characterization accorded the interests and the factual decision reached as to the intent of the parties but this view was confined to so-called "royalty" interests intended to outlast any one individual lease. There is no suggestion in either of the cases that a royalty interest granted by a lessor and tied to a specific lease or leases would be regarded as a *profit à prendre* carrying with it the right to go upon the land and take oil and gas.

<sup>69</sup> *Supra*, n. 45.

<sup>70</sup> (1937) 110 S.W. (2d) 53 at 56-57.

<sup>71</sup> Williams and Meyers, 1 *Oil and Gas* s. 313.3, *McCall v. Nettles* (1948) 251 Ala. 349, 37 So. (2d) 635; *Hassie Hunt Trust v. Proctor* (1952) 215 Mis. 84, 60 So. (2d) 551, 1 O. & G.R. 1644.

<sup>72</sup> Williams and Meyers, 1 *Oil and Gas* s. 313.4; *Hartness v. Young* (1956) 299 P. (2d) 171, 5 O. & G.R. 742.

<sup>73</sup> Levy, *supra*, n. 9 at 320 and 324.

<sup>74</sup> Apparently created by a landowner granting in fee & right to share in a percentage of petroleum production. *Blake, The Oil and Gas Lease, Part Two*, (1940) 13 So. Cal. L. Rev. 393 at 393 and 415.

<sup>75</sup> (1935) 43 P. (2d) 788.

<sup>76</sup> (1935) 52 P. (2d) 237.

Indeed in *Callahan v. Martin* it was said that an operating lessee has an interest in real property in the nature of a *profit à prendre*, which is an incorporeal hereditament, and further that an assignee of a royalty interest from a landowner also has an interest or estate in real property in the nature of an incorporeal hereditament. But where that interest was given subject to an existing oil and gas lease the court made it quite clear that it was another type of incorporeal hereditament—a rent, or at least something analogous to a rent.<sup>77</sup> The decision in *Dabney-Johnston v. Walden*<sup>78</sup> was to the same effect. Indeed, in that case it was said that the lessor who has granted an oil and gas lease has only a reversionary interest in the right to drill for and produce oil.<sup>79</sup>

In any event none of the reasoning in respect of landowner's royalties created in perpetuity would seem to be applicable to overriding royalties necessarily limited to the life of the leases upon which they are created. Yet in the later Californian case of *Payne v. Callahan*<sup>80</sup> (in which Mr. Levy was a counsel for the respondents) the court held such an overriding royalty to be *profit a prendre* in gross, ignoring the basis of the decision in *Callahan v. Martin* while purporting to apply it.

It is submitted that while there is no Canadian authority directly on the question, Canadian courts will not follow the approach taken by the Californian courts in respect of either royalties or overriding royalties where no express right to enter, drill and produce is given. It is therefore submitted that it can safely be asserted that to hold royalty agreements to be *profit à prendre* would be contrary to the intentions of both parties to the usual royalty agreement. That is not to say that an operating lessee could not grant to another or reserve to himself a co-tenancy in a *profit à prendre* but in so doing he would be creating something quite different from a royalty interest.

### 3. *The overriding royalty as a rent or an interest analogous to a rent.*

In 1928, A. W. Walker Jr., of the University of Texas wrote of the desirability of treating royalty interests as interests in land.<sup>81</sup> He saw that there were problems with conflicting authorities even within Texas.<sup>82</sup> However, notwithstanding the apparent distinction between in kind and money royalties adopted in *Hager v. Stakes*<sup>83</sup> he submitted that money royalties were interests in land. He saw them as *rents-seck* which are realty as they issue out of a freehold estate.

After Walker's article the confusion of Texas authorities was apparently resolved by Greenwood J. in *Sheffield v. Hogg*, where unaccrued royalties payable in money were said to be profits, in the nature of rent, issuing out of a determinable fee simple in the mineral estate.

There are numerous other authorities from various jurisdictions, including England and Canada,<sup>84</sup> in which royalties have been held to be

<sup>77</sup> *Supra*, n. 72 at 795.

<sup>78</sup> *Supra*, n. 73.

<sup>79</sup> *Id.* at 244.

<sup>80</sup> (1940) 99 P. (2d) 1050.

<sup>81</sup> Walker, *supra*, n. 18 at 37.

<sup>82</sup> *Id.* at 38-49.

<sup>83</sup> *Supra*, n. 57.

<sup>84</sup> *R. v. Westbrook* (1847) 10 Q.B. 178; *Daniel v. Gracie* (1844) 6 Q.B. 145; *Re Dawson and Bell*, *supra*, n. 31; *Tennant v. Dunn*, *supra*, n. 67.

rents, notwithstanding Lord Halsbury's remark in *Greville-Nugent v. Mackenzie*.<sup>85</sup>

In speaking of coal, for instance, we talk constantly about the "rent" and "royalty" of coal. The phrases are figurative: you pay rent in one sense it is true but rent generally has been understood to be a return from the soil and not to be a consumption or taking of the soil; whereas, of course where the soil consists of coal and other minerals you are actually taking it away.

It may be worth examining one or two of these authorities. In *Arrington v. United Royalty Company*,<sup>86</sup> an Arkansas case, royalties were again regarded as rents, in the nature of rent charges. Indeed they were said to be incident to the reversion, though transferable apart from it. In respect of this statement it should be pointed out that in fact rent charges arise where there is not tenurial relationship involved and are quite independent of reversions as such.<sup>87</sup> However, the essential point is that royalties were held to be in the nature of rent charges. Thus no tenurial relationship was required and it did not matter that the oil and gas "lease" was not properly a lease.<sup>88</sup> No fuller reasons were given for that decision.

A slightly lengthier discussion leading to the same result took place in *Callahan v. Martin*, a California case earlier referred to. There it was said that "the royalty return which the lessee renders to his lessor . . . is rent, or so closely analogous to rent as to partake of the incidents thereof."<sup>89</sup> Reference was made to *United States v. Noble*<sup>90</sup> where it had been laid down that rents and royalties were profits issuing out of the land. Numerous other cases were cited as recognizing the view that the right to receive future rents and oil royalties is an incorporeal hereditament.<sup>91</sup>

Walker had regarded royalties as *rents-seck*; the courts have preferred to regard them as rent charges. Since 1730 there has been little to choose between those two types of interest as the English Landlord and Tenant Act, 1739,<sup>92</sup> gave to holders of *rents-seck* the right of distress, the lack of which had formerly distinguished them from rent charges. While in many respects it seems sensible to regard lessor's royalties as interests in land, as rents in the nature of rent charges, some theoretical and historical difficulties present themselves as obstacles to holding such a view to be sound in principle. These difficulties may be even more significant in relation to overriding royalties.

The major problem is that the mark of a rent is said to be the possibility of distraining in order to recover it.<sup>93</sup> It has already been noted that one Canadian court has said that the oil and gas "lease" does not carry with it a common law right of distress, not being in the true sense a lease.<sup>94</sup> However, that remark was *obiter* as the issue was not before

<sup>85</sup> [1900] A.C. 83 at 87.

<sup>86</sup> (1933) 65 S.W. (2d) 36.

<sup>87</sup> Megarry and Wade, *supra*, n. 17 at 697.

<sup>88</sup> Contrast this decision with the view of Williams C.J.Q.B. in *Langlois v. Canadian Superior Oil of California Ltd.* (1957) 23 W.W.R. 401.

<sup>89</sup> *Supra*, n. 72.

<sup>90</sup> (1915) 237 U.S. 74.

<sup>91</sup> *Beam v. Dugan* 132 Cal. App. 546, 23 P. (2d) 58; *Kern Sunset Oil Co. v. Good Roads Oil Co.* 214 Cal. 435, 6 P. (2d) 71; *Adams v. Petroleum Midway Co.* 205 Cal. 221, 270 P. 668; *Clark v. Richfield Oil Co.* 127 Cal. App. 495, 16 P. (2d) 162.

<sup>92</sup> 4 Geo. II, c. 29, s. 5.

<sup>93</sup> 23 *Halsbury's Laws* 536-537 (3rd. ed. Simonds 1955).

<sup>94</sup> *Supra*, n. 60.

the court and Langlois C.J.Q.B. did not in that case direct his mind to the possibility of the royalty being a rent charge. But even if the royalty is viewed as a rent charge the difficulty remains. For centuries it has been said to follow from distress being the mark of a rent that a rent cannot be reserved out of an incorporeal hereditament. By definition only corporeal things can be physically taken hold of. Thus licensors have been held to be unable to levy distress upon their licensees to force payment of occupation fees.<sup>95</sup> Indeed in 1925 it was thought necessary to expressly authorize the raising of a rent charge out of another rent charge in the English Law of Property Act.<sup>96</sup>

The problem is of significance, of course, because the lessor under an oil and gas lease receives his royalty payment in return for the granting of an incorporeal hereditament to the lessee. The lessee who retains an override upon assignment of his interest not only has that difficulty to overcome but also the fact that at no time did he have anything more than an incorporeal hereditament. The freehold lessor, having a corporeal interest in the land, could perhaps argue that he is in a stronger position.

There is however, some room for argument that a royalty reserved out of a *profit à prendre* may be regarded as a rent. The Crown has always been conceded the prerogative right to levy distress for payments raised out of incorporeal hereditaments,<sup>97</sup> though that will not take us far in respect of overrides. Secondly, it is said that one who grants to another the incorporeal right to vesture and herbage for the feeding of cattle can levy distress.<sup>98</sup> In such cases it is said that the thing is manurable.<sup>99</sup> Can it not be argued that the owner of an oil and gas royalty is in a similar position, whether he be lessor or override owner? Just as cattle are distrainable in a physical sense, so is mining machinery and equipment. There is nothing impractical about levying distress against such machinery as a remedy. Furthermore, while the operating lessee's interest is said to be incorporeal he was given, at common law, an interest in the surface of the land which closely approaches corporeality even if limited only to use for such purposes as are necessary to the enjoyment of his *profit à prendre*.<sup>100</sup>

This argument finds support in an article written by R. J. Blake in 1940 which takes a similar view for similar reasons.<sup>101</sup> However, neither the confident exposition of that view in that article nor the slender authorities upon which it is based remove all doubts about its applicability in principle. *Coke on Littleton*<sup>102</sup> and various cases<sup>103</sup> do contain statements to the effect that a rent may be reserved out of a demise of vesture or herbage because the thing is manurable and distress may be levied. But the herbage demise was clearly regarded as a special case; an exception, and no positive encouragement towards the scope of that exception is found in the cases.

<sup>95</sup> *Hancock v. Austin* (1863) 14 C.B. (N.S.) 634, 143 E.R. 593; *Errington v. Errington and Woods* [1952] 1 K.B. 290.

<sup>96</sup> Law of Property Act, 1925 (Imp.), s. 121.

<sup>97</sup> Blake, *supra*, n. 71 at 411, n. 178 citing 2 *Tiffany Real Property* 1465, s. 405, (2nd ed. 1920).

<sup>98</sup> *Coke on Littleton* 47a.

<sup>99</sup> Or mainourable, or maynorable. Taken to mean capable of being seized.

<sup>100</sup> The common law right is affected in Alberta by the Right of Entry Arbitration Act, R.S.A., 1970, c. 322 and in Saskatchewan by the Surface Rights Acquisition and Compensation Act, S.S. 1960, c. 73.

<sup>101</sup> *Supra*, n. 95.

<sup>103</sup> *Gray's Case* 5 Co. Rep. 78, 77 E.R. 174; *Mayor of Northampton's Case* 1 Wils. K.B. 107, 95 E.R. 519; *Wilson v. Mackreth* 3 Burr 1824, 97 E.R. 1119; *Welch v. Myers* 4 Camp. 368, 171 E.R. 117, and see also Joshua Williams, *Right of Common and Other Prescriptive Rights* (1877) at 20.

Mr. Blake is, nevertheless, confident that "the true royalty interest possesses the legal incidents of rent,"<sup>104</sup> whether created by reservation or grant, lessor, landowner, or lessee.<sup>105</sup> Although he seems to slide over the difficulties mentioned above, he does not ignore them and anyone wishing to be convinced that a royalty is an interest in land would very likely be satisfied. After all, the lessee, who assigns reserving an override, is stipulating for part of what he formerly had under his *profit à prendre* which admittedly is an interest in land—the part being the right to a portion of, or the value of a portion of, any petroleum substances won.

If however, the Canadian courts boggle at the task of circumnavigating the old rule against raising rents out of incorporeal hereditaments it will be necessary to try a different tack, perhaps that suggested by Levy.<sup>106</sup> It may be possible to persuade them to treat royalties as a distinct class of incorporeal hereditament. The argument could be bolstered by reference to pronouncements of United States Courts such as the following:<sup>107</sup>

The difficulty is due in part to the fact that the oil industry is of very recent development, while in this country, by statute and judicial precedent, our classification of property as realty or personalty is based on common law definitions which crystallised in a time when oil interests were not the subject of judicial cognizance.

And:<sup>108</sup>

The oil industry . . . is largely dependent for development, growth or prosperity, on the doctrine that the interests we are considering . . . are interests in land. . . . Were the fundamental contracts, on which the oil business so largely rests, [to] be adjudged by the Supreme Court to create mere rights in personalty at some uncertain date in the future, the structure of the business would be seriously, if not fatally, jeopardized.

If the courts will not accept royalties as rent charges, or analogous thereto, or as a distinct species of incorporeal hereditament there seems to be no other way of affording those interests the necessary protection without specific legislation. It is not thought sound to treat assignments of oil and gas leases as subleases as has been done in Louisiana on the ground that by reserving royalty the lessee-assignor is retaining a reversionary interest.<sup>109</sup> As was said in *Walsingham's Case*<sup>110</sup> centuries ago, "an estate in the land is a time in the land, or land for a time." The reservation of a royalty does not amount to the creation of a reversionary estate even if it does signify the retention of some interest in the land. This argument is well disposed of in an article written in the *California Law Review* in 1938.<sup>111</sup>

## V. CONCLUSION

The issue is a difficult one and the prediction of its outcome is hazardous. As noted earlier the general opinion in Canadian courts has been that lessor's royalties are rents or are sufficiently analogous to

<sup>104</sup> Blake, *supra*, n. 71 at 393, 410.

<sup>105</sup> *Id.* at 410-422.

<sup>106</sup> Levy, *supra*, n. 9.

<sup>107</sup> Callahan v. Martin, *supra*, n. 72 at 791.

<sup>108</sup> Sheffield v. Hogg, *supra*, n. 58 at 1024. These two quotations are being used slightly out of context but it is felt that nevertheless the argument is sound.

<sup>109</sup> Bond v. Mid-States Oil Corp. (1951) 219 La 415, 53 So. (2d) 149.

<sup>110</sup> (1573) 2 Pl. Com. 547, 75 E.R. 205.

<sup>111</sup> Kuechler, *Overriding Royalties: Proceeds Interests* (1938) 26 Cal. L. Rev. 480.



rents to be treated as such for a number of purposes. It has been remarked that the analogy:<sup>112</sup>

when carried beyond the lessor-lessee relationship to the carved out royalty, the production payment and the overriding royalty where the recipient has no interest in the resource 'in place', ceases to define accurately the nature of the payment or interest.

However, the difficulties in the way of treating the royalty as a rent-charge, which seems more accurate than treating it as a leasehold rent, seem no greater in the case of the override than in the case of the lessor's royalty. After all, even the lessor who does have an interest in the oil and gas *in situ* does not, if he grants the usual oil and gas lease, receive his royalty in return for the giving of any interest in the substance *in situ*.<sup>113</sup> And the lessor who acquires his oil and gas interest from the Crown and then grants an oil and gas lease has no more interest in the oil and gas *in situ* than does the lessee who takes the "lease" from him.

The policy considerations requiring the treatment of both lessor's royalties and overrides as interests in land are overwhelming. Previously the courts have been moved by such considerations to treat certain licenses as licenses coupled with a grant in order to afford them some of the protection given to interests in land. The writer predicts that the courts will take a similar course in respect of overriding and other royalties. On what ground this will be done is another question. Unless the courts are prepared to give great weight to an argument by analogy from the demise of herbage and minimize its historically exceptional status, it is submitted that they ought to treat them as a distinct species of incorporeal hereditament. However, in view of the approach long taken towards mining of minerals and the preponderance of oil and gas authorities in favour of treating such payments as rent, the likely course will be to continue to regard lessor's royalties as rent and to extend that treatment to overriding royalties. The ground in law for doing this will probably be the analogy and the practical similarity between two kinds of royalty. Both would appear to be, in the same sense, profits arising out of the land. The *St. Lawrence Petroleum* case<sup>114</sup> will probably be confined to its own peculiar fact situation. However, so disposing of the *Emerald Resources* case<sup>115</sup> will be more difficult notwithstanding that no firm decision on the point was handed down. It will probably be necessary to reject the reasoning in that case.

In addition it is submitted that if an overriding royalty in the hands of the lessee/assignor is an interest in land, then upon assignment in part or in whole to a third party it must remain an interest in land. In *Fuller v. Howell*<sup>116</sup> it was held that the assignee of a lessor's royalty received only a contractual right and this case is cited without disapproval in Lewis and Thompson's *Canadian Oil and Gas*.<sup>117</sup> However, the statements accepting the argument that a *profit à prendre* is a contractual right and not an interest in land lends little authority to this decision.<sup>118</sup> The oil and gas lease out of which the royalty had originally

<sup>112</sup> *Rae, supra*, n. 3.

<sup>113</sup> *Berkheiser v. Berkheiser, supra*, n. 16.

<sup>114</sup> *Supra*, n. 10.

<sup>115</sup> *Supra*, n. 10.

<sup>116</sup> [1942] 1 D.L.R. 462.

<sup>117</sup> S. 109, Law 1744.

<sup>118</sup> *Supra*, n. 113 at 464-465.

been reserved had terminated in any event, thus putting an end to the royalty interest even if it had been regarded as an interest in land. The writer further disagrees, for reasons set out earlier, with Lewis and Thompson's assertion that the assignment of royalties is merely an assignment of a chose in action,<sup>119</sup> though, the form of words used would, of course, be of great importance.

It should be noted, however, that the assignment must, if it is to convey an interest in land, be an assignment of the whole or a part of the assignor's royalty interest and not of something so qualified as to be in fact pure personalty.<sup>120</sup>

Lastly, no reason is found in the cases to treat a royalty interest created by grant as deserving different treatment in law from such an interest created by reservation.<sup>121</sup> And it is further submitted that if the courts accept, as they appear to, the definitions of "royalty" and "overriding royalty" set out at the beginning of this paper,<sup>122</sup> an interest described in those terms should be regarded as a royalty or overriding royalty regardless of whether or not the expressions "royalty" or "overriding royalty" are used. For an agreement to be held to constitute a lease it is not necessary that it be expressly described as such, nor does it matter that it is called a license, provided that the essential elements of a lease are to be found in the agreement.<sup>123</sup>

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<sup>119</sup> *Supra*, n. 114, Law 1748.

<sup>120</sup> *St. Lawrence Petroleum Co. v. Bailey Selburn Oil Co.*, *supra*, n. 10, provides an example of this.

<sup>121</sup> The reasoning in *Fuller v. Howell* being rejected.

<sup>122</sup> *Supra* at 233.

<sup>123</sup> *Lippman v. Lee Yick* [1953] O.R. 514, (1953) 3 D.L.R. 527; *Danita Investments Pty. Ltd. v. Rockstrom* (1962) 80 W.N. (N.S.W.) 1287; [1963] N.S.W.R. 1275; *Ex parte Robert John Pty. Ltd., Re Fostars Shoes Pty. Ltd.* [1963] S.R. 260, (1963) 80 W.N. 408; *Errington v. Errington* [1952] 1 K.B. 290, [1952] 1 All E.R. 149; and see Williams, *Canadian Law of Landlord and Tenant* 8-9 (3rd ed. 1957).