

Goodmans^{LLP} Update

Court of Appeal Clarifies Scope of Vesting Orders to Extinguish Interests Against Land; Royalty Interests may be Protected

The Ontario Court of Appeal (the “ONCA”) recently released its second and final decision in *Third Eye Capital Corporation v. Ressources Dianor Inc./Dianor Resources Inc.*, providing increased clarity on when interests in or against land can be extinguished through vesting orders in insolvency proceedings. The main question before the ONCA was whether a third party interest in land in the nature of a Gross Overriding Royalty (“GOR”) can be extinguished by a vesting order granted in a receivership proceeding. The decision, which confirms that an insolvency court has jurisdiction to extinguish third party interests in land through vesting orders, sets out a “rigorous cascade analysis” for courts to use in making such a determination. Applying that analysis, the ONCA held that, given the nature of the GORs in question, the lower court erred in extinguishing them from title. However, the ONCA did not grant the appeal because it was out of time.

Background

In December 2012, Ressources Dianor Inc./Dianor Resources Inc. (“Dianor”) ceased operations, and on August 20, 2015, Richter Advisory Group Inc. was appointed by the Ontario Superior Court (Commercial List) as receiver of the assets, undertakings, and properties of Dianor (the “Receiver”). The receivership application was brought by Third Eye Capital Corporation (“Third Eye”), Dianor’s secured creditor, who was owed approximately C\$5.5 million. Dianor’s main assets were mining claims located in Ontario and Quebec, which included agreements that provided for the payment of GORs for diamonds, metals, and minerals in favour of 2350614 Ontario Inc. (the “Royalty Holder”). Notices of the agreements granting the GORs were registered on title to both the surface rights and the mining claims in favour of the Royalty Holder.

In October 2015, an order was made approving a process for the sale of Dianor’s mining claims. Two bids were submitted to acquire Dianor’s property, both of which were conditional on the GORs being terminated. The Receiver selected the bid made by Third Eye. On notice to the Royalty Holder and other impacted stakeholders, the Receiver sought Court approval of the sale to Third Eye and a vesting order extinguishing the GORs. The motion judge held that the GORs were not interests in land and granted an order that approved the sale and extinguished the GORs.

When the appeal was first heard in 2018, the ONCA held that the motion judge erred in determining that the GORs did not amount to interests in land; the ONCA held they did. The ONCA based their conclusion on the Supreme Court of Canada (“SCC”) decision in *Bank of Montreal v. Dynex Petroleum Ltd.* (2002) (“Dynex”). In *Dynex*, the SCC held that, for a royalty to be considered an interest in land, a two-part test must be satisfied, namely (i) the language used in describing the interest must be sufficiently precise to show that the parties intended the royalty to be a grant of an interest in land, and not simply a contractual right, and (ii) the interest out of which the royalty is carved must be itself an interest in land.

At the appeal in 2018, the ONCA had a number of questions which remained to be answered and requested further submissions and argument as to whether, and under what conditions and limitations, the court had jurisdiction to extinguish a third party interest in land through vesting orders. The recent ONCA decision followed those further submissions and argument.

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ONCA's 2019 Decision

In the second part of its decision in the *Dianor* case, the ONCA concluded that, based upon a broad, liberal, and purposive interpretation of the *Bankruptcy and Insolvency Act* (the “**BIA**”) receivership provisions, courts implicitly have jurisdiction to approve a sale proposed by a receiver. The ONCA further held that the broad wording of the BIA also confers jurisdiction to grant vesting orders in the insolvency context, and that the power to use vesting orders is incidental and ancillary to a receiver's power to sell.

The ONCA then provided a three-step framework for courts to apply in determining if a third party interest should be extinguished through a vesting order. First, the courts should assess the nature and strength of the interest proposed to be extinguished. The ONCA drew a distinction between a fee simple interest and a fixed monetary interest, noting that fee simple interests and some lesser interests in land, such as active easements, may not be extinguishable due to their nature. It would be more appropriate, the ONCA held, to extinguish an interest akin to a fixed monetary interest attached to real property, such as a mortgage or tax lien. Fundamental to this consideration is a determination of whether the owner of the interest has a reasonable expectation of the interest having a continuing nature which, absent consent, cannot be involuntarily extinguished in the ordinary course through a payment in lieu.

Second, it is important for courts to consider whether the parties consented to the vesting of the interest at the time of the sale approval before the court or through prior agreement. Freely negotiated agreements, the ONCA held, reflect the parties' express intention and should be given sufficient weight.

Third, if the first two considerations are inconclusive, courts can consider the equities, including (a) the prejudice, if any, to the third party interest holder; (b) whether the third party may be adequately compensated for its interest from the sale proceeds; (c) whether, based on evidence of value, there is equity in the property; and (d) whether the parties are acting in good faith. The ONCA noted that this is not an exhaustive list and there may be other factors that are relevant to the analysis.

In the case at hand, the ONCA found the Royalty Holder's GOR was more than a fixed monetary interest that attached to the property; they were, in substance, an interest in a continuing and inherent feature of the property. Although the GOR, like a fee simple interest, is capable of being valued at a point in time, this did not transform the substance of the interests into one that is concerned with a fixed monetary sum rather than an element of the property itself. The interest represented by the GOR is an ownership in the product of the mining claim, either payable by a share of the physical product or a share of revenues.

It was also clear the Royalty Holder had not consented to the vesting of its interests and that no agreement allowing for any competing priority existed. The ONCA did not need to consider the equities because the first and second parts of the analysis were conclusive. On these bases, the ONCA found the motion judge erred in granting an order extinguishing the Royalty Holder's rights in the GORs.

Ultimately, however, the ONCA found the Royalty Holder had been aware for weeks of the desire to vest out the GORs and that it neglected to properly preserve its rights, submitting its appeal too late, and would not set aside the motion judge's order.

Implications of the Decision

Before the ONCA's decision in this case, courts have exercised their inherent jurisdiction, looking at the facts and equities of the case, to determine in each instance whether to grant the requested vesting of assets to extinguish third party interests against land, including royalty interests. This resulted in a patchwork of case law. This ONCA decision now provides courts with a framework for making such determinations and provides comfort for holders of interests in land that there are principles which limit and guide a court's ability to extinguish those rights.

This case will be of particular interest to holders of royalty interests in the mining sector, where the use of royalties is common practice. Based on the principles set out in this decision, stakeholders in the mining sector should bear in mind the following when dealing with royalty interests:

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- Parties should be careful to clearly construct the documents creating and governing royalty interests, to ensure that those agreements properly deal with their structure, their nature and their relative priorities. In particular, parties should be mindful of the role of implied consents to vesting, including in situations where a third party has subordinated its interest contractually.
- Where a purchase offer mandates the extinguishment of royalty interests, parties should obtain expert evidence as to whether there is any value in the royalty interests and whether the proposed compensation for the royalty interest is adequate.
- Where a royalty holder wishes to file an appeal, the holder should be mindful of statutory deadlines and filing requirements, as the courts may not offer leniency in this regard.

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