

To Vest, or Not to Vest? Royalties and the Court's Power to Extinguish Third-party Interests in Land Through a Vesting Order

Charles Newman

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The Ontario Court of Appeal released its second decision in the Dianor Resources Inc. (Dianor) receivership. In its first decision, *Third Eye Capital Corporation v. Ressources Dianor Inc./Dianor Resources Inc.*, 2018 ONCA 253, pronounced on March 15, 2018, the Court determined that certain gross overriding royalties (GORs) were 'interests in land.' In this second decision, the Court of Appeal addresses when a court can grant a vesting order to transfer property free and clear of an interest in land.

This decision will be of particular interest to lenders, royalty holders, and restructuring professionals as they determine how best to structure transactions.

Background

On August 20, 2015, a receiver was appointed over the assets and properties of Dianor on the application of Dianor's secured creditor, Third Eye Capital Corporation (Third Eye) pursuant to section 243 of the *Bankruptcy and Insolvency Act* (Canada) (the BIA) and section 101 of the *Courts of Justice Act* (Ontario) (the CJA). Dianor's main asset was a group of mining claims that were subject to the GORs. The GORs were registered against the mining claims and were described in their terms as interests in land.

Following a bidding process for Dianor's assets conducted by the receiver, two offers were received, both of which required that title to the mining claims be transferred free and clear of the GORs. The accepted offer was a partial credit bid by Third Eye, which used expert evidence to determine the present value of the GORs and provided for payment of that amount to the GOR holders on closing. The transaction was scheduled to close two days after the granting of an approval and vesting order, and within the appeal period under both the CJA and the BIA, provided that there was not an extant appeal.

The motion judge held that the court had jurisdiction under section 243 of the BIA and section 100 of the CJA to order that property be vested in a purchaser free and clear of any encumbrance, including the GORs. The motion judge held that the GORs were not interests in land, but regardless of their nature, the court had jurisdiction to vest the property in the purchaser free and clear of the GORs.

In its first decision, the Ontario Court of Appeal overturned the motion judge's determination that the GORs

were not interests in land. In doing so, the Court relied on the test set out by the Supreme Court of Canada in *Bank of Montreal v. Dynex Petroleum Ltd.*, 2002 SCC 7, which confirmed that a royalty constitutes an interest in land if: (i) 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 resource recovered from the land (in that case, oil and gas), and (ii) the interest out of which the royalty is carved, is itself an interest in land.

The Ontario Court of Appeal requested additional submissions to address whether, as an interest in land, the GORs could be extinguished and whether a Superior Court judge has jurisdiction to extinguish a third-party interest in land pursuant to a vesting order.

Issues Considered by the Court

[1] Can a third-party interest in land, such as the GORs, be extinguished by a vesting order granted in a receivership proceeding?

[2] Does a Superior Court judge have jurisdiction to extinguish a third-party interest in land through a vesting order under section 243 of the BIA and section 100 of the CJA?

Key Takeaways

- The Court held that the BIA is remedial legislation that should be given a liberal interpretation to achieve its objectives, which frequently includes the liquidation of assets. Therefore, a Superior Court judge has jurisdiction under the BIA to grant a vesting order which provides for the conveyance of title free and clear of all encumbrances (including, where appropriate, interests in land).
- When granting a vesting order that will extinguish the rights of a third-party to an interest in land, the court should assess, (i) the nature and strength of the interest to be extinguished and (ii) whether the parties have consented to the vesting of their interest. A key inquiry is whether the interest in land is more similar to a monetary interest (i.e., similar to a mortgage or tax lien) that is attached to the real or personal property or whether the interest is more similar to a fee simple that is in substance an ownership interest. An ownership interest is generally tied to an inherent feature of property, rather than a fixed monetary obligation where the interest is extinguished once the obligation is paid in full. In other words, an ownership interest is of a continuing nature that cannot be extinguished without the consent of the owner.
- The priority of the interests represented in negotiated agreements must be considered when determining whether an interest in land may be vested off title. This includes considering whether the third-party has contractually or otherwise subordinated its interest to a secured creditor. The court must consider the intention of the parties where they have negotiated and agreed to the priority of their interests.

- If the priority of the interests under the agreements is unclear, the court may consider the equities to determine if a vesting order is appropriate in the circumstances. The court may assess whether (i) any prejudice exists to the third-party interest holder, (ii) the third-party may be adequately compensated for its interest from the proceeds of the disposition or sale, (iii) based on evidence of value, there is any equity in the property, and (iv) whether the parties are acting in good faith. The court may also identify other factors that may be relevant to this analysis.
- In determining whether the appeal period under the CJA or BIA applies in Ontario, the court is required to determine the source of the power to grant the subject order. Where the power is derived under the BIA, the BIA appeal period of 10 days applies. Where the power is derived under the CJA, and normal Ontario rules apply, the standard 30-day appeal period applies. If there is an operational or purposive inconsistency between the federal bankruptcy rules and provincial rules with respect to the timing of an appeal, the doctrine of federal paramountcy would cause the federal bankruptcy rules to prevail. In this case, the Court held that the vesting order was granted solely under the jurisdiction of the BIA, and therefore the BIA appeal period applied. In this case, the appellant missed the appeal deadline, and the Court held that it was not appropriate to grant an extension.
- The Court also noted that, absent urgency that is highlighted to the court when the request for the vesting order is made, the Receiver should not close a sale within the appeal period.

For further information on this topic, please contact Lance Williams, Charles Newman, Taschina Ashmeade or any member of the Banking, Lending & Specialty Finance Group.

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