

# Ontario Court of Appeal Provides Guidance on Vesting Orders in Receivership - and Beyond

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By Miranda Spence

Vesting orders have become one of the most powerful tools in an insolvency professional's toolkit, providing a purchaser with the comfort that the encumbrances contributing to the debtor's financial difficulties cannot follow to the new owner. In light of their importance, Canadian insolvency and banking professionals were understandably anxious when the Ontario Court of Appeal (the "OCA" or the "Court") recently asked for submissions on whether receivership vesting orders can extinguish third party interests in land in the nature of a Gross Overriding Royalty (a "GOR").<sup>1</sup>

The highly-anticipated decision in *Third Eye Capital Corporation v. Ressources Dianor Inc./Dianor Resources Inc.*<sup>2</sup> was released in June 2019. The Court held that, while receivership courts have the jurisdiction to grant vesting orders, whether such order **should** be granted must be determined through a rigorous analysis. The Court developed and applied what it terms a three-part "cascade" analysis and determined that due to the nature of the GOR in this case, it could not be vested out.<sup>3</sup> Although the Court ultimately upheld the vesting order due to a procedural technicality relating to the appeal period, the newly-established framework is expected to limit the availability of such orders in the future.

The Court's confirmation that receivership courts generally have the jurisdiction to issue vesting orders over assets in a receivership affirmed Canadian insolvency professionals' common understanding. However, the Court surprised a number of observers who took the stance that nothing was sacred in a vesting order, and who expected the Court to affirm the receivership court's expansive jurisdiction to effectively vest any interest. Going forward, receivers and debtors will have to spend more time negotiating with holders of non-monetary real property interests, who now hold more power than they did before. In contrast, a number of banking professionals and lenders are likely sleeping more soundly knowing that the security provided by a GOR is not as easily disposed of as simple monetary interests.

These issues and future considerations for stakeholders in a receivership are detailed below.

## Background

Dianor Resources Inc. ("**Dianor**") was an exploration company focused on exploring and developing diamond-bearing properties in Canada which ceased active operations in 2012.<sup>4</sup> The company's main assets were a portfolio of properties across Ontario and Quebec. Several of these properties were subject to certain GORs in favour of 2350614 Ontario Inc. (the "**GOR Holder**"), as well as royalty rights in minerals in favour of Essar Steel Algoma Inc. (the "**Royalty Rights Holder**").

Receivership proceedings were initiated against Dianor in August 2015 by Third Eye Capital Corporation ("**Third Eye**"), Dianor's senior secured creditor. Richter Advisory Group Inc. was appointed as receiver (the "**Receiver**").

## The Sale and Vesting of Dianor's Assets

Within the receivership, the Receiver ran a sales process for Dianor's assets which yielded two bids for the mining claims, both of which included the condition that the GORs be terminated or significantly reduced.

Third Eye was the successful bidder and the Receiver sought an order (a) approving the sale and (b) vesting the assets free and clear of the GORs and royalty rights in exchange for compensation. The Royalty Rights Holder, which was undergoing its own restructuring proceedings at the time, was content to

permit its rights to be vested out. The GOR Holder, while not opposing the sale, asked that the mining claims be transferred subject to the GORs. The motion judge approved the asset sale, determined that the GORs were not interests in land, and vested the GORs accordingly. The GOR Holder appealed the receivership court's decision by serving and filing a notice of appeal 29 days after the date the receivership court's reasons were released.

### **OCA 2018 Decision: GORs Are Interests in Land**

The initial hearing of the appeal took place in May 2017, and the first part of the decision was released in March 2018. The Court held that the GORs were interests in land, but asked for further submissions on whether those interests could be vested out and whether the appeal had been brought out of time.<sup>5</sup>

The parties made further submissions in September 2018, and part two of the Court's decision was released in June 2019. The Court discussed the receivership court's general authority to issue vesting orders, and then considered when it would be appropriate to do so, having regard for the nature of the interest to be vested, among other factors.

### **OCA 2019 Decision: Can the Receivership Court Issue Vesting Orders?**

The Court considered that, although the BIA does not expressly confer upon a receivership court the jurisdiction to grant vesting orders, this absence is just the beginning of the analysis. The Court undertook a detailed review of the history of receivership proceedings and reasoned that, since the well-established purpose of a receivership is to "enhance and facilitate the preservation and realization of the assets for the benefit of creditors ... [which] purpose is generally achieved through a liquidation of the debtor's assets,"<sup>6</sup> the BIA should be interpreted in a manner that advances that purpose and facilitates the liquidation of assets. As explained by the Court, when executing a liquidation, it is inherent to the process that (a) the receiver will not hold title to the assets it has taken control of, but that (b) the receiver must nonetheless be authorized to sell those assets. The Court held that section 243(1)(c) must be interpreted as bridging that title gap by giving the receivership court the ability to empower a receiver to "take any other action that the court considers advisable."<sup>7</sup> Section 243(1)(c) is therefore the source of the Court's power to vest out assets, which is necessary for the conveyance of title to be effective.<sup>8</sup>

### **OCA 2019 Decision: When Should the Receivership Court Issue a Vesting Order?**

While finding that s. 243(1)(c) gives the receivership court the power to vest assets, the Court cautioned that "the exercise of that jurisdiction is not unbounded."<sup>9</sup> The Court then established a three-part cascade analysis to be used in determining whether a third-party interest should be extinguished, as follows:

1. **What is the nature and strength of the interest in land?** Where on the spectrum of monetary versus true property interest does the interest lie? On one end of the spectrum is a fixed monetary interest such as a mortgage or a lien for municipal taxes, while on other is a fee simple which is in substance an ownership interest in some ascertainable feature of the property itself.<sup>10</sup>
2. **Have the parties consented to the vesting of the interest?** Such consent may have been given either at the time of the sale, or through prior agreement, such as through contractual subordination.<sup>11</sup>
3. **What do the equities demand?** If the first two factors prove ambiguous or inconclusive, a court may consider the equities to determine whether granting a vesting order is appropriate. Among other things, the court may consider: prejudice to the third party, if any; whether the third party could be adequately compensated for the extinguishment; whether there is any equity in the property being sold; and whether the parties are acting in good faith.<sup>12</sup>

In applying the cascade analysis to the facts before it, the Court reviewed the nature of the GOR and found that it was an interest in a continuing and inherent feature of the property itself.<sup>13</sup> While this did not elevate the GOR to the level of a pure fee simple interest, it was closer to that end of the spectrum than to the fixed monetary interest end of the spectrum. Further, there was no consent to the vesting by the GOR Holder. Because there was no ambiguity in the first two factors of the framework, the Court did not have to consider the equities and held that the GOR should not have been vested out.

Although the GOR should not have been vested, the Court found that the GOR Holder had waited too long to appeal and did not meet the test for extending time.<sup>14</sup> As such, the original transaction was allowed to stand.

### **Dianor's Applicability in Proposal and CCAA Asset Sales**

The Court identified the specific statutory provisions that apply to asset sales in BIA proposals and CCAA proceedings, noting that it was not considering such sales in its analysis of whether a receivership court has the jurisdiction to vest out assets. In our view, while the jurisdiction to vest is express in proposal and CCAA scenarios, it is likely that courts will look to the analytic framework developed by the Court to assess whether a vesting order is appropriate based on the facts of a specific matter. As such, parties dealing in any insolvency proceeding will find *Dianor* instructive.

### **Considerations for Stakeholders in Receiverships Going Forward**

Going forward, we recommend that parties consider the following when dealing with a GOR interest:

- When drafting a royalty agreement:
  - GOR holders should ensure that the agreement reflects the intention to create an interest in land, if that is the intent. Secured lenders should ensure that they review royalty agreements as part of their due diligence when drafting loan documents, and require that any future royalty interests be subject to their review.
  - The royalty should be registered on title.
- Both GOR grantors and lenders should consider the impact of entering into a subordination and postponement agreement, which may imply consent to vest the royalty interests.
- In the event a vesting order is issued, if the GOR holder wishes to appeal, such appeal should be raised as soon as possible and, in any event, within 10 days of the issuance of the vesting order.
- Receivers and purchasers should ensure that searches are done on applicable real property registries and land title offices to confirm whether there are any royalty holders who should be given notice of the sale and vesting order being sought.
- Receivers and purchasers should consider whether closing deadlines comply with appeal periods and whether they should wait out the appeal period before closing a transaction. The notice given to the service list, whether anyone appeared and/or objected to the order, and whether any parties have indicated they may appeal are all factors to consider in making such a decision.
- In the event a purchaser insists on closing before expiry of the appeal period, the receiver should consider whether the court, the service list or others need to be notified of such intention.

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<sup>1</sup> Different authorities give different definitions of royalties and the sub-classes of royalties that are established in Canada (including net smelter returns royalties, net profit interests royalties and GORs). Generally speaking, a royalty is a payment to the holder of the royalty by the mineral project owner, which payment is based on either a percentage of the value of minerals produced or a percentage of the revenue generated from the sale of those minerals. Royalty interests can also be granted in the oil and gas context.

<sup>2</sup> *Third Eye Capital Corporation v. Ressources Dianor Inc./Dianor Resources Inc.*, 2019 ONCA 508 [Dianor].

<sup>3</sup> *Ibid* at para 115.

<sup>4</sup> Application Record affidavit para 10.

<sup>5</sup> *Supra* note 1 at para 18. Specifically, the OCA requested further submissions and argument on the following issues: (1) Whether and under what circumstances and limitations a Superior Court judge has jurisdiction to extinguish a third party's interest in land, using a vesting order, under s. 100 of the CJA and s. 243 of the BIA, where s. 65.13(7) of the BIA; s. 36(6) of the CCAA; ss. 66(1.1) and 84.1 of the BIA; or s. 11.3 of the CCAA do not apply; (2) If such jurisdiction does not exist, should this court order that the Land Title register be rectified to reflect 235 Co.'s ownership of the GORs or should some other remedy be granted; and (3) What was the applicable time within which 235 Co. was required to appeal and/or seek a stay and did 235 Co.'s communication that it was considering an appeal affect the rights of the parties.

<sup>6</sup> *Ibid* at para 73.

<sup>7</sup> The Court undertook a similar historical analysis in the recent case of *Business Development Bank of Canada v. Astoria Organic Matters Ltd.*, 2019 ONCA 269, wherein the Court concluded that s. 243(1)(c) includes the power to include a "leave to sue" provision in a receivership order. Taken together, these cases represent a trend in the jurisprudence reflecting that the receivership court's jurisdiction pursuant to s. 243(1)(c) should be interpreted as including the power to make any order that is necessary to effect the purpose of a receivership, as described above.

<sup>8</sup> *Ibid* at paras 76 to 80.

<sup>9</sup> *Ibid* at para 82.

<sup>10</sup> *Ibid* at paras 103 to 105.

<sup>11</sup> *Ibid* at paras 106 to 107.

<sup>12</sup> *Ibid* at para 110.

<sup>13</sup> *Ibid* at paras 111 to 113.

<sup>14</sup> *Ibid* at para 147.

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