

Commercial Litigation Insolvency & Corporate Restructuring

www.pallettvalo.com

August 2019

Bankruptcies, Land Claims, and Limitation Periods

Ontario Court of Appeal provides long overdue guidance on Vesting Orders

The Ontario Court of Appeal recently delivered a decision which provides much-needed guidance on both the power and limitations of vesting orders in Receivership proceedings.

A “vesting order” is a tool that courts may use to transfer the ownership of land to another entity, without a formal legal conveyance, in circumstances where the court considers it fair and just to do so.

Vesting orders are often sought and obtained in the context of bankruptcy proceedings, particularly when the bankrupt party owns property, but another party also has some entitlement to ownership of that same property.

If the court determines that title should be transferred to the other party with an ownership interest, this can occur by way of a vesting order. On the other hand, if a third party purchases the property, the court can extinguish the ownership rights of any other party by issuing a vesting order.

In the insolvency context, a vesting order is often thought of as a magic wand to convey property, as there is little case law to set out the limits on its use. In *Third Eye Capital Corporation v. Ressources Dianor Inc./Dianor Resources Inc.*, the Court of Appeal stepped into the breach and confirmed that, although vesting orders can be used to extinguish interests in land, a two-part test has to be applied to determine whether this is appropriate in the circumstances. It was concluded that this power should be exercised if the interest in land is strictly monetary, but not where the interest is substantive and goes to the heart of title.

This decision should be seen as a positive development in the bankruptcy context, because by clarifying what interests can be extinguished by means of a vesting order it makes encumbered real property assets easier to convey. However, it also places strict limits on vesting orders and provides protection to parties who hold strong beneficial interests in land.

The Facts

Dianor Resources Inc. (“Dianor”) is a mining and exploration company that became insolvent and went into Receivership in 2015.

Vesting orders are often sought and obtained in the context of bankruptcy proceedings, particularly when the bankrupt party owns property, but another party also has some entitlement to ownership of that same property.

Dianor’s primary asset was a group of mining claims in Ontario and Quebec, including a large precious minerals project near Wawa, Ontario (the “Mining Claims”). Dianor had purchased the Mining Claims from 2350614 Ontario Inc (“235”) in exchange for *Gross Overriding Royalties* (“GORs”)

payable to 235 for diamonds and other metals and minerals extracted.

Aside from the GORs, the Mining Claims were also subject to royalty rights in favour of Essar Steel Algoma Inc. (“Algoma”).

Notices for both the GORs and the royalty rights were registered on title to the Mining Claims.

Dianor ceased operating in 2012. Upon its insolvency, the Receiver noted that the Mining Claims were unlikely to yield anything when Dianor's assets were liquidated.

The Vesting Order

When Dianor went into Receivership, Third Eye Capital Corporation ("Third Eye") offered to purchase the Mining Claims for \$2 million. However, Third Eye's offer was conditional on the GORs and the royalty rights being extinguished.

To facilitate Third Eye's purchase, \$250,000 of the purchase price would go to 235 for the GORs and \$150,000 would be paid to Algoma for its royalty rights. These amounts were based on expert valuation on fair market value. Third Eye's offer was accepted by the Receiver in December, 2015, conditional on the Receiver obtaining court approval.

When the Receiver applied to the court to approve the sale to Third Eye, it also sought a vesting order to extinguish 235's GORs and Algoma's royalty rights. Algoma supported the proposed sale and the vesting order. 235 did not oppose the sale, but it requested that the Mining Claims remain subject to the GORs when they vested in Third Eye.

On approving the sale, the motion judge held that the GORs did not constitute an interest in land and the vesting order extinguished the GORs from the title to the Mining Claims.

The Appeal

235 appealed the motion judge's ruling. Its notice of appeal was filed with the court eight days after the sale transaction closed; which was 29 days after the Receiver received approval for the sale of the Mining Claims and obtained the vesting order.

The appeal was done in two stages. In the first stage, the Ontario Court of Appeal disagreed with the motion judge's decision and held that the GORs did indeed constitute a valid interest in land.

In the second stage, the Court of Appeal asked for submissions on two other issues. The first issue was substantive in nature and it addressed whether a third party interest in land in the nature of a GOR can be extinguished by a vesting order granted in a Receivership proceeding. The second issue was a procedural question regarding the applicable limitations period - namely, whether the order granted by the Motions Judge is governed by the appeal period set out in the *Bankruptcy and Insolvency Act* (the "BIA") or the *Courts of Justice Act* (the "CJA").

An Interest in Property can be Wiped-Out by Using a Vesting Order

In evaluating the first issue, the court canvassed the literature and case law on vesting orders in order to appreciate their purpose and significance, particularly in the insolvency context.

The court noted that the inherent purpose of a vesting order is to affect the transfer of assets to a purchaser on a free and clear basis. At the same time, a vesting order is intended to preserve and maintain the priority of competing claims against the vendor-debtor for the proceeds generated by the sale transaction. Therefore, the court explained that, "...provided there is a basis on which to grant an order vesting property in a purchaser, there is a power to vest out interests on a free and clear basis so long as the terms of the order are appropriate and accord with the principles of equity".

In this context, the Court of Appeal turned to section 243 of the *BIA*, which grants a court power to appoint a Receiver on application by a secured creditor. Once appointed the Receiver can take possession of assets, exercise control over the bankrupt's property, or "take any other action that the court considers advisable". The court took a close look at the history

of section 243 and its legislative purpose and reasoned that the jurisdiction to vest assets in a purchaser in the context of a Receivership is consistent with the objectives of section 243.

It was held that section 243 of the *BIA* gives the court jurisdiction to authorize a

Receiver to enter into an agreement to sell property and "...in furtherance of that power, to grant an order vesting the purchased property in the purchaser". In this particular case, section 243 gave the Receiver the power to enter into an agreement to sell Dianor's property, to seek the court's approval of the sale, and to obtain a vesting order to give effect to the approved sale.

When an Interest in Land should be Extinguished by a Vesting Order

Even though the Court of Appeal determined that the motion judge had jurisdiction to issue the vesting order, that did not necessarily mean that the order should have extinguished 235's GORs. The court explained that this particular issue was one of "appropriateness" of the vesting order and not of "jurisdiction".

It was noted that, "...in considering whether to grant a vesting order that serves to extinguish rights, a court should adopt a rigorous cascade analysis". This analysis, the court explained, is

"...in considering whether to grant a vesting order that serves to extinguish rights, a court should adopt a rigorous cascade analysis"

to be carried out through a two-part test to determine whether a third-party interest should be extinguished through a vesting order.

The first prong of the test is to assess the “...nature and strength of the interest that is proposed to be extinguished”. The court stated that the answer to this question alone can determine the test without regard to other factors.

In assessing the nature and strength of the interest in land, the court stressed that a key factor is whether the interest is akin to a fixed monetary stake (like a mortgage) or an ownership (or fee simple) interest in the property. The latter interest is stronger insofar as it is tied to the inherent characteristics of the land and cannot be extinguished once a monetary obligation is fulfilled. The owner of a fee simple interest has a substantive stake in the land that is continuous and cannot be involuntarily extinguished through payment.

The second prong of the test is to consider whether the parties have consented to the vesting of the interest, either at the time of the sale before the court or through a prior agreement. The court explained that this consideration is important because vesting orders are a routine aspect of insolvency law and are typically granted on an unopposed basis. However, the issue becomes more complex when consent is given through a prior agreement and a dispute arises as to the nature (or existence) of this agreement.

The court also explained that if the two factors of the test yield a result that is ambiguous or inconclusive, a consideration of the equities may be undertaken to determine if a vesting order is appropriate. The equities that should be considered include:

- (a) whether the third party interest holder would be prejudiced by the granting of a vesting order;
- (b) whether the third party may be adequately compensated for its interest from the proceeds of the sale;
- (c) whether there is any equity in the property based on evidence of its value; and
- (d) whether the parties have acted in good faith.

This list of equities is not exhaustive and the court noted that other factors may be considered if they are relevant to the analysis.

In applying its test, the Court of Appeal held that a GOR constitutes a substantive interest in land, and not a monetary

interest. The GORs held by 235 for the Mining Claims therefore comprised a strong fixed interest in the property rather than a monetary interest.

Given this determination, and 235’s lack of consent to extinguish its interest, the court did not have to consider the equities. It was held that, although the court had jurisdiction to grant a vesting order, the motion judge still erred in granting a vesting order to extinguish 235’s interest in the Mining Claims in the nature of the GORs.

The Applicable Appeal Period

In respect of vesting orders in Receivership applications, the court held that the applicable appeal period is the 10-day period set out in Rule 31 of the *BIA* and not the 30-day period set out in Rule 61.04(1) of the *Rules of Civil Procedure* (as prescribed by the *CJA*). In coming to this conclusion, the court reasoned that the route of appeal should depend on the jurisdiction under which the order is granted. The appeal in this case was from an approval order for the sale of the Mining Claims. The court’s jurisdiction to approve the sale and the vesting order was within the *BIA*. As such, the provisions of the *BIA* should govern the appeal.

235 therefore had 10 days to appeal the order of the motion judge, as set out in the *BIA*. The appeal was not commenced within this time frame and it was therefore dismissed because it was out of time. As such, Third Eye was successful in having the sale upheld by the court.

The court also noted that after a sale and vesting order is approved by the court, a Receiver should not close the related sale transaction until the 10-day appeal period expires.

Lessons Learned

The Court of Appeal has now provided some long overdue clarity on vesting orders which has been lacking in the case law. The court specifically noted that its decision is reflective of the inherently flexible nature of the insolvency system in Canada. However, the court also confirmed that, while it is important to promote the “...maximization of proceeds and realization of the debtor’s assets”, it is equally important to protect legitimate third party interests in land.

Given this conclusion, debtors should not be apprehensive in seeking vesting orders to acquire title to real property assets. At the same time, parties who hold strong interests in those assets can rest assured that their rights will be protected.



Daniel Waldman is a member of the Commercial Litigation Practice.



Alex Ilchenko is a member of the Commercial Litigation and Insolvency & Corporate Restructuring Practices.

Pallett Valo LLP Commercial Litigation Practice

Our firm has the largest Commercial Litigation department in Peel Region, with the depth and expertise to provide legal advice and representation in complex litigation matters. Our clients are served with advice that is designed to minimize and avoid risks and business disruption through alternative dispute resolution mechanisms, and decisive and aggressive action in the courts when necessary.

Contact Members of our Commercial Litigation Practice:

Ahmed Bulbulia

abulbulia@pallettvalo.com • (905) 273.3022 ext. 211

Anna Esposito

aesposito@pallettvalo.com • (905) 273.3022 ext. 260

Ann A. Hatsios

ahatsios@pallettvalo.com • (905) 273.3022 ext. 320

Manpreet Kaur

mkaur@pallettvalo.com • (905) 273.3022 ext. 214

Sudevi Mukherjee-Gothi

sgothi@pallettvalo.com • (905) 273.3022 ext. 285

Scott Price

sprice@pallettvalo.com • (905) 273.3022 ext. 221

John Russo

jrusso@pallettvalo.com • (905) 273.3022 ext. 282

Daniel Waldman

dwaldman@pallettvalo.com • (905) 273.3022 ext. 241

Monty Dhaliwal

mdhaliwal@pallettvalo.com • (905) 273.3022 ext. 228

Ted Evangelidis

tevangalidis@pallettvalo.com • (905) 273.3022 ext. 250

Alex Ilchenko

ailchenko@pallettvalo.com • (905) 273.3022 ext. 203

Anne M. Kennedy

akennedy@pallettvalo.com • (905) 273.3022 ext. 204

Jeffrey S. Percival

jpercival@pallettvalo.com • (905) 273.3022 ext. 264

Maria Ruberto

mruberto@pallettvalo.com • (905) 273.3022 ext. 206

Neeta Sandhu

nsandhuy@pallettvalo.com • (905) 273.3022 ext. 210

Marc D. Whiteley

mwhiteley@pallettvalo.com • (905) 273.3022 ext. 255

Pallett Valo LLP Insolvency & Corporate Restructuring Practice

We provide legal advice to debtors, secured and unsecured creditors, trustees and receivers in the context of proceedings under the “Bankruptcy & Insolvency Act” (BIA) and the “Companies Creditors Arrangement Act” (CCAA). Over the course of the last several years, we have guided lenders, suppliers and landlords through numerous significant CCAA proceedings.

Contact Members of our Insolvency & Corporate Restructuring Practice:

Joe Conte

jconte@pallettvalo.com • (905) 273.3022 ext. 217

Alex Ilchenko

ailchenko@pallettvalo.com • (905) 273.3022 ext. 203

Monty Dhaliwal

mdhaliwal@pallettvalo.com • (905) 273.3022 ext. 228

John Russo

jrusso@pallettvalo.com • (905) 273.3022 ext. 282



This article provides information of a general nature only and should not be relied upon as professional advice in any particular context. For more information about Commercial Litigation or Insolvency & Corporate Restructuring, contact a member of our **Commercial Litigation Practice or Insolvency & Corporate Restructuring Practice at 905.273.3300.**

If you are receiving this bulletin by mail and you would prefer to receive future bulletins by email, visit www.pallettvalo.com/signup or send an email to marketing@pallettvalo.com.

Pallett Valo LLP will, upon request, provide this information in an accessible format.

77 City Centre Drive, West Tower, Suite 300, Mississauga, Ontario L5B 1M5 • 1.800.323.3781