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Ontario Court of Appeal Decision Provides Guidance on the Application of *Dynex*

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Case Commented On: *Third Eye Capital Corporation v Ressources Dianor Inc*, 2018 ONCA 253 (CanLII)

In 2002 the Supreme Court of Canada handed down its decision in *Bank of Montreal v Dynex Petroleum Ltd*, 2002 SCC 7 (CanLII) in which it confirmed that a gross overriding royalty (GOR) carved out of a working interest in oil and gas rights was capable of subsisting as an interest in land as a matter of law. In an earlier post on post-*Dynex* litigation I observed that:

> Whether any particular GORR created an interest in land, or simply a contractual claim, depends upon the intentions of the parties as revealed in the language adopted by the parties to describe the GOR. There is presumably no objection to expressing this intention with words such as "the parties intend that the right and interest created by clause x of this agreement is to be an interest in land" – so long as this intention is not contradicted by other language in the agreement when construed as a whole in accordance with the usual rules on the interpretation of contracts.

This case tested that last proposition since the agreement giving rise to the GORs (executed post-*Dynex* – at para 58) provided that

> 4.1 It is the intent of the parties hereto that the GOR shall constitute a covenant and an interest in land running with the Property and the Mining Claims and all successions thereof or leases or other tenures which may replace them, whether created privately or through governmental action, and including, without limitation, any leasehold interest.

Notices of the GORs were registered in the relevant registries. The agreement giving rise to the GORs provided that once Dianor became the owner of the subject mining claims the optionors "shall retain a twenty percent (20%) …[GOR] for diamonds and a one and a half percent (1.5%) [GOR] gross overriding royalty (GOR) for all other metals and minerals." The royalty was to be calculated in accordance with a Schedule.

The status of the royalty interest became an issue when Dianor was put in receivership pursuant to s 243 of the *Bankruptcy and Insolvency Act*, RSC 1985, c B-3 *("*BIA*"),* and s 101 of the *Courts of Justice Act*, RSO 1990 c C.43 ("CJA"). The receiver organized a court approved bid process for Dianor's assets including its mining claims. Both bids received were conditional on termination or significant reduction of the GORs. The motions judge (Justice Newbould, 2015 ONSC 6086 (CanLII)) concluded that he could make a vesting order authorizing the sale of Dianor's mining claims free and clear of the GORs on terms that required a cash payment to the

GOR holder that was "higher than the mid-point of the range of values" determined by expert testimony. In reaching that conclusion Justice Newbould concluded that the GORs were not interests in land. Justice Newbould gave two principal reasons for that conclusion (notwithstanding the clear statement of intention in s 4.1 (above) and registration of the GORs). First, the GOR holder had no right to enter the property to explore and extract diamonds or other minerals. And second, the schedule in the GORs designed to calculate the value of the royalty made it clear that the GOR was a GOR on the proceeds of production and not an interest in the land itself. Here Justice Newbould relied heavily on pre-*Dynex* decisions of the Alberta courts, notably *Vanguard Petroleums Ltd v Vermont Oil & Gas Ltd*, [1977] 1 ACWS 172, 1977 CanLII 648 (AB QB), and *Emerald Resources Ltd v Sterling Oil Properties Mgmt Ltd* (1969), 3 DLR (3d) 630 (Alta CA), aff'd 1970 CanLII 980 (SCC).

Justice Newbould went on to observe (although making no finding on the point) that logic suggested that he could also make the vesting order on the terms prescribed even if the GORs *were* interests in land.

On appeal Justice Lauwers writing for a unanimous panel concluded that Justice Newbould erred in concluding that these GORs did not give rise to interests in land; and he has invited further argument on the question of whether or not Justice Newbould had the jurisdiction to make a vesting order on terms which extinguished the GORs when acting under s 100 of the *CJA* and s 243 of the *BIA* (and for greater certainty when the Court is not acting under s 65.13(7) of the BIA; s 36(6) of the *Company Creditors Arrangement Act*, RSC 1985, c C-36 (*CCAA)*; ss 66(1.1) and 84.1 of the BIA; or s 11.3 of the *CCAA).*

The appeal judgment dealt with both aspects of Justice Newbould's reasoning on the GOR. Thus Justice Lauwers recognized that the fact that the agreements did not give the owner of the GOR the right to work the minerals could not support the conclusion that the GOR did not create an interest in land. GORs are always passive interests and to require that a GOR provide the right to work would make sure that no GOR could ever qualify as an interest in land—a conclusion which is clearly completely inconsistent with *Dynex*. As for the second line of reasoning, Justice Lauwers confirms, and most helpfully, that language in the GOR agreement that references the proceeds of production as a means of ascertaining the value of the GOR once the product is severed from the ground does not "defeat the clear intention of the parties that the GORs constitute interests in land" (at para 77). In reaching this conclusion Justice Lauwers was evidently (at para 54) influenced by the reasons of the Alberta Court of Appeal in *Dynex* (largely endorsed by Justice Major in the Supreme Court's decision) and especially the statement to the effect (1999 ABCA 363 (CanLII) para 73) that a court must "examine the parties' intentions from the agreement as a whole, along with the surrounding circumstances, as opposed to searching for some magic words." Here, the key to the intentions of the parties was the express statement of that intent coupled with registration in the relevant land registries.

Let us hope that Justice Lauwers' decision definitively ends the search for magic words that ties the grant of the royalty to the resource in the ground. After all, in the real world the parties also need to address the issue of how to calculate the value of the royalty with respect to products that, once extracted, require additional processing and transportation before value can be

determined. That practical necessity cannot be allowed to preclude parties from taking advantage of the Supreme Court's decision in *Dynex*.

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