Court file no: CV-15-11080-00CL

ONTARIO SUPERIOR COURT OF JUSTICE
COMMERCIAL LIST

B E T W E E N:

THIRD EYE CAPITAL CORPORATION

Applicant

- and –

RESSOURCES DIANOR INC./DIANOR RESOURCES INC.

Respondent

BOOK OF AUTHORITIES

(re: Sale Approval and Vesting Order)

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September 22, 2016

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Bank of Montreal, Appellant v. Enchant Resources Ltd. and D. S. Willness, Respondents

McLachlin C.J.C., Gonthier, Iacobucci, Major, Bastarache, Binnie, LeBel JJ.

Heard: November 9, 2001
Judgment: January 24, 2002
Docket: 27766

Proceedings: additional reasons to 2001 CarswellAlta 1461 (S.C.C.); affirming (1999), 182 D.L.R. (4th) 640, 74 Alta. L.R. (3d) 219, [2000] 2 W.W.R. 693, 2 B.L.R. (3d) 58, 15 C.B.R. (4th) 5, 15 P.P.S.A.C. (2d) 179, (*sub nom.* Bank of Montreal v. Enchant Resources Ltd.) 255 A.R. 116, (*sub nom.* Bank of Montreal v. Enchant Resources Ltd.) 220 W.A.C. 116 (Alta. C.A.); reversing (1995), 39 Alta. L.R. (3d) 66, [1996] 6 W.W.R. 461, 11 P.P.S.A.C. (2d) 291 (Alta. Q.B.); and reversing (1997), 50 Alta. L.R. (3d) 44, [1997] 6 W.W.R. 104, 31 B.L.R. (2d) 44, 46 C.B.R. (3d) 36, 145 D.L.R. (4th) 499, 202 A.R. 331, 12 P.P.S.A.C. (2d) 183 (Alta. Q.B.)

Counsel: *Richard B. Jones*, for Appellant
James C. Crawford, Q.C., *Frank R. Dearlove*, *Scott H.D. Bower*, for Respondents

Subject: Natural Resources; Property; Corporate and Commercial; Insolvency

Headnote

Oil and gas --- Exploration and operating agreements — Royalty agreement — General

Overriding **royalty** interest could, subject to intention of parties, be interest in land.

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Overriding **royalty** interest could, subject to intention of parties, be interest in land.

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Pétrole et gaz naturel --- Concessions pétrolières et gazières — Questions diverses

Droit de redevance dérogatoire pouvait constituer un intérêt foncier, à condition que telle ait été l'intention des parties.

D Ltd. and its predecessor companies granted overriding **royalty** and net profit interests, respecting D Ltd.'s oil and gas leases, to E Ltd. and W. The bank was D Ltd.'s secured creditor. D Ltd. was petitioned into **bankruptcy**. The trustee wanted to sell all the oil and gas properties of D Ltd. One issue was whether any sale would be subject

to overriding **royalties** arising out of the working interest held by D Ltd. The bank brought an application for determination that an overriding **royalty** was incapable of being an interest in land.

The chambers judge granted the application. He found that, as a matter of law, a lessee of an oil and gas lease obtained from a lessor could not pass an interest in land to a third party.

E Ltd. and W's appeal was allowed.

The Court of Appeal concluded that overriding **royalty** interests could constitute interests in land if intended by the parties.

The bank appealed.

Held: The appeal was dismissed.

Royalty arrangements were common forms of arranging exploration and production in the oil and gas industry. The owner of minerals in situ would typically lease to a potential producer the right to extract the minerals, known as a working interest. An overriding **royalty** is a **royalty** granted normally by the owner of a working interest to a third party in exchange for consideration.

At common law, an interest in land could not issue from an incorporeal hereditament.

The oil and gas industry was governed by a combination of statute and common law. Some common law concepts, developed in different social, industrial and legal contexts, were inapplicable in the unique context of the industry and its practices.

The bank could not offer any convincing reasons for maintaining the common law prohibition on the creation of an interest in land from an incorporeal hereditament. Given the custom in the oil and gas industry and the support found in case law, it was proper and reasonable that an overriding **royalty** interest could, subject to the intention of the parties, be an interest in land.

D ltée, ainsi que les compagnies l'ayant précédée, a accordé à E ltée et W un droit de redevance dérogatoire et un droit aux profits nets, et ce, conformément aux concessions pétrolières et gazières dont elle bénéficiait. La banque était le créancier garanti de D ltée. D ltée a fait l'objet d'une requête de mise en faillite, laquelle a été accordée. Le syndic de faillite voulait vendre tous les avoirs gaziers et pétroliers de D ltée. Une des questions en litige était celle de savoir si la vente serait conclue sous réserve des redevances dérogatoires provenant de la participation directe détenue par D ltée. La banque a présenté une demande pour qu'il soit statué qu'une redevance dérogatoire ne pouvait constituer un intérêt foncier.

Le juge en chambre a accueilli la demande. Il a conclu que, en droit, le preneur à bail d'une concession pétrolière et gazière, obtenue d'un bailleur, ne pouvait transmettre un intérêt foncier à un tiers.

Le pourvoi de E ltée et W a été accueilli.

La Cour d'appel a estimé que les droits de redevance dérogatoire pouvaient constituer des intérêts fonciers si telle était l'intention des parties.

La banque a interjeté appel.

Arrêt: Le pourvoi a été rejeté.

Les arrangements en matière de redevances étaient de pratique courante dans le secteur de l'exploration et de la production pétrolières et gazières. D'ordinaire, le propriétaire des minéraux in situ donne à bail à un producteur potentiel le droit d'extraire les minéraux, lequel droit est connu sous le nom de « participation directe ». Une redevance dérogatoire est une redevance accordée normalement par le titulaire d'une participation directe à un tiers en échange d'une contrepartie.

En common law, un intérêt foncier ne pouvait être issu d'un héritage incorporel.

Le secteur des hydrocarbures était régi par un ensemble de lois et de règles de common law. Certaines notions de common law élaborées dans des contextes sociaux, industriels et juridiques différents étaient inapplicables dans le contexte particulier de ce secteur d'activité et de ses pratiques.

La banque n'a pu invoquer aucune raison convaincante justifiant le maintien de la règle de common law qui interdit la création d'un intérêt foncier à partir d'un héritage incorporel. Vu la coutume dans le secteur des hydrocarbures et l'appui fourni par la jurisprudence, il était opportun et raisonnable de reconnaître qu'un droit de redevance dérogatoire pouvait constituer un intérêt foncier, à condition que telle ait été l'intention des parties.

Annotation

The Supreme Court of Canada's decision in *Dynex Petroleum* is a "landmark" case and a "must read" for all practitioners of oil, gas and mining law. First and foremost, it settles, probably once and for all, the seemingly long-standing debate over the juridical nature of oil and gas **royalties** (which, judging from the extensive jurisprudence and academic commentary leading up to the *Dynex Petroleum* litigation, seems to have enjoyed somewhat of a mixed pedigree). Although the implications of *Dynex Petroleum* may ultimately extend far beyond oil and gas **royalties** in scope and Alberta in jurisdiction, the whole oil and gas industry that gives rise to the *Dynex Pretroleum* litigation is uniquely associated with Alberta, and it is fitting that the Supreme Court's reasons for this appeal from the Alberta Court of Appeal is delivered by none other than Mr. Justice John Major, himself an alumnist of the Alberta judiciary.

Greatly summarized, a "working interest" is a right given be a fee owner to a miner to extract minerals and is an incorporeal hereditament in the nature of a *profit à pendre*. It is this working interest that gives rise to payments known as "**royalties**", either back to the fee owner (a "lessor's **royalty**") or to a third party, typically a supplier (an "overriding **royalty**"), in each case based on the value of the minerals extracted.

In a well written decision, Mr. Justice Major concludes that **royalties** can, in fact, be interests in real property if the owner of the working interest and the owner of the **royalty** entitlement intended that the **royalties** constituted a right in the unproduced minerals *in situ*. In so doing, Mr. Justice Major considers and then rejects the age-old common law rule that any interest issuing from an incorporeal hereditament cannot, in and of itself, become, or constitute an interest in, real property.

The principal practical consequence of such a finding is, of course, that the title to the **royalties** and the relative priorities of the **royalties** *vis-à-vis* other encumbrances of the land can now be governed by the race or race-notice provisions of the applicable real property title registration regimes. This was precisely the issue adjudicated in *Dynex Petroleum*. From a strictly policy perspective, this is not such a terrible result since minerals *in situ* are, by nature, permanently situated and well suited to a legal description or address driven search engine like a real property register. Furthermore, it seems as if the practice of protecting **royalties** by the registration of caveats under the real

property legislation was already a well ensconsed customary protocol for protecting **royalties** long before *Dynex Petroleum* was decided.

This annotator's endorsement of the *Dynex Petroleum* decision does not come without certain caveats of its own. First of all, this annotator is not entirely comfortable with the assertion that a property interest is either real or personal depending upon the intent of the parties creating the interest. The whole concept that the intent of the immediate parties to the conveyance (and yes, "conveyance" would be a technically appropriate term for a transfer of an interest in land) governs the juridical nature of the interest is somewhat troubling, especially given that it is precisely third parties (i.e. parties *not* involved in the creation of the interest) that most desperately need the protection of objective rules by which to determine whether a given interest is real or personal (in order to search and register appropriately). The immediate parties to the conveyance are bound to each other in contract, if nothing else, and do not typically need, as against each other, to distinguish between real and personal property being conveyed.

This annotator also admits to being somewhat confused with the Supreme Court's assertion that "[**r**]**oyalties**, as used in the oil and gas industry, make sense only if they are property interests in unproduced minerals [*in situ*]." Although this annotator has no familiarity whatsoever with the business practices surrounding the granting of **royalties**, this annotator intuitively comes to the opposite conclusion: **royalties** make no sense if they are property interests in unproduced minerals *in situ*. If a **royalty** truly was an undivided percentage right in the minerals, that would make it something like a *defacto* assignment of an undivided fractional interest in the working interest itself. Instead, **royalties** seem somewhat more akin to promises given by the owner of the working interest to pay certain unspecified amounts for certain period(s), the exact quantum of each such payment being a direct function of the total amount extracted during such period(s). It might be illustrative to consider what might be the case if the owner of the working interest fails to extract any minerals, oil or gas notwithstanding its working interest, or extracts same inefficiently or incompetently. Is there then some remedy by **royalty** holders to seize the working interest and extract the riches themselves? If **royalties** are truly "property rights in unproduced minerals" one would expect that type of remedy. If, however, there is no such right on the part of **royalty** holders to seize and work the working interest themselves, then the **royalty** would look much like any other unsecured promise to pay.

Although probably considered a "win" for **royalty** owners generally (certainly the holding in *Dynex Petroleum* favoured the **royalty** owners who had registered their respective caveats on title long before competing real property lenders), the finding may ultimately prove to be a "double-edged sword" for **royalty** owners. So, while *Dynex Petroleum* validates the process of registering caveats at land registry offices to perfect and preserve priorities in **royalties**, by confirming that a **royalty** can be an interest in land if the language manifests such an intent, the law after *Dnynex Petroleum* pretty well mandates that such **royalties** must always now be registered on title lest priority or title be lost. Furthermore, query whether all of the implications of such a finding have percolated through the oil and gas industry. For instance, but without limitation: what are the potential tax consequences?; does the *Statute of Frauds* now apply to **royalty** deals?; and what are the appropriate limitation periods for enforcing **royalties**?

This annotator also notes that it may be possible to export the *ratio* in *Dynex Petroleum* beyond the confines of oil and gas **royalties**, as there is nothing in the reasons that limits the finding to just **royalties**. According to *Dynex Petroleum*, interests issuing from *any* incorporeal hereditaments can be interests in land, depending upon manifested intent. Although it is not immediately clear to this annotator what the long term implications of a wide-spread application of the *ratio* in *Dynex Petroleum* might be, it is interesting to note that, aside from a *profit à pendre*, the largest body of recognized incorporeal hereditaments is actually easements. Could it be that rights issuing out of or in respect of easements can now also be interests in land capable of binding the fee owner?

Jeffrey W. Lem

Davies Ward Phillips & Vineberg LLP

Table of Authorities

Cases considered by *Major J.*:

Bank of Montreal v. Dynex Petroleum Ltd. (1999), 182 D.L.R. (4th) 640, 74 Alta. L.R. (3d) 219, [2000] 2 W.W.R. 693, 2 B.L.R. (3d) 58, 15 C.B.R. (4th) 5, 15 P.P.S.A.C. (2d) 179, (sub nom. *Bank of Montreal v. Enchant Resouces Ltd.*) 255 A.R. 116, (sub nom. *Bank of Montreal v. Enchant Resources Ltd.*) 220 W.A.C. 116, 1999 ABCA 363 (Alta. C.A.) — considered

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Isaac v. Cook (1982), [1983] N.W.T.R. 11, 44 C.B.R. (N.S.) 39, 43 A.R. 1 (N.W.T. S.C.) — referred to

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Scurry-Rainbow Oil Ltd. v. Galloway Estate, 8 Alta. L.R. (3d) 225, 138 A.R. 321, [1993] 4 W.W.R. 454 (Alta. Q.B.) — referred to

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Vandergrift v. Coseka Resources Ltd. (1989), 67 Alta. L.R. (2d) 17, 95 A.R. 372 (Alta. Q.B.) — considered

Vanguard Petroleums Ltd. v. Vermont Oil & Gas Ltd., [1977] 2 W.W.R. 66, 4 A.R. 251, 72 D.L.R. (3d) 734 (Alta. T.D.) — referred to

Words and phrases considered

overriding royalty

. . . **royalty** arrangements are common forms of arranging exploration and production in the oil and gas industry in Alberta. Typically, the owner of minerals *in situ* will lease to a potential producer the right to extract such minerals. This right is known as a working interest. A **royalty** is an unencumbered share or fractional interest in the gross production of such working interest. A lessor's **royalty** is a **royalty** granted to (or reserved by) the initial lessor. An overriding **royalty** or a gross overriding **royalty** is a **royalty** granted normally by the owner of a working interest to a third party in exchange for consideration which could include, but is not limited to, money or services (e.g., drilling or geological surveying). G. J. Davies, "The Legal Characterization of Overriding **Royalty** Interests in Oil and Gas" (1972), 10 *Alta. L. Rev.* 232, at p. 233. The rights and obligations of the two types of **royalties** are identical. The only difference is to whom the **royalty** was initially granted.

Termes et locutions cités

redevance dérogatoire

. . . les arrangements en matière de redevances sont de pratique courante en Alberta dans le secteur de l'exploration et de la production pétrolières et gazières. D'ordinaire, le propriétaire des minéraux *in situ* donne à bail à un producteur potentiel le droit d'extraire ces minéraux. Pour désigner ce droit, on utilise l'expression « participation directe ». Une redevance est une part ou participation fractionnaire non grevée dans la production brute issue de cette participation directe. La redevance du bailleur est une redevance accordée au bailleur initial (ou qu'il se réserve). Une redevance dérogatoire ou redevance dérogatoire brute est une redevance accordée normalement par le titulaire d'une participation directe à un tiers en échange d'une contrepartie qui peut comprendre notamment une somme d'argent ou des services (par exemple, le forage ou les études géologiques). G. J. Davies, « The Legal Characterization of Overriding **Royalty** Interests in Oil and Gas » (1972), 10 *Alta. L. Rev.* 232, p. 233. Les mêmes droits et obligations se rattachent aux deux types de redevance. Seul les différencie le fait que la redevance n'est pas accordée initialement à la même personne.

ADDITIONAL REASONS to judgment reported at 2001 CarswellAlta 1461, 2001 CarswellAlta 1462 (S.C.C.), dismissing appeal by bank from judgment reported at 182 D.L.R. (4th) 640, 1999 CarswellAlta 1271, 74 Alta. L.R. (3d) 219, [2000] 2 W.W.R. 693, 2 B.L.R. (3d) 58, 15 C.B.R. (4th) 5, 15 P.P.S.A.C. (2d) 179, (sub nom. *Bank of Montreal v. Enchant Resouces Ltd.*) 255 A.R. 116, (sub nom. *Bank of Montreal v. Enchant Resources Ltd.*) 220 W.A.C. 116, 1999 ABCA 363 (Alta. C.A.), allowing appeal from judgments granting applications for determination that overriding **royalty** was incapable of being interest in land.

MOTIFS SUPPLÉMENTAIRES au jugement publié à 2001 CarswellAlta 1461, 2001 CarswellAlta 1462 (S.C.C.), qui a rejeté le pourvoi de la banque à l'encontre du jugement publié à 182 D.L.R. (4th) 640, 1999 CarswellAlta 1271, 74 Alta. L.R. (3d) 219, [2000] 2 W.W.R. 693, 2 B.L.R. (3d) 58, 15 C.B.R. (4th) 5, 15 P.P.S.A.C. (2d) 179, (sub nom. *Bank of Montreal v. Enchant Resouces Ltd.*) 255 A.R. 116, (sub nom. *Bank of Montreal v. Enchant Resources Ltd.*) 220 W.A.C. 116, 1999 ABCA 363 (Alta. C.A.) qui a accueilli le pourvoi à l'encontre des jugements accueillant les demandes présentées afin qu'il soit statué qu'une redevance dérogatoire ne pouvait constituer un intérêt foncier.

Major J.:

I. Introduction

1 This appeal arises from an application made by the appellant Bank of Montreal before the chambers judge in the Alberta Court of Queen's Bench for a determination that, as a matter of law, an overriding **royalty** is incapable of being an interest in land. The application was opposed by several defendants including the respondents in this Court, Enchant Resources Ltd. ("Enchant") and D. S. Willness ("Willness"), each holders of overriding **royalties** who claim their interests to be interests in land. The learned chambers judge allowed the Bank's application which the Alberta Court of Appeal

reversed, holding that an overriding royalty is capable of being an interest in land. This appeal to the Supreme Court of Canada was dismissed with reasons to follow.

II. Facts

2 The material filed and submissions of counsel indicated that royalty arrangements are common forms of arranging exploration and production in the oil and gas industry in Alberta. Typically, the owner of minerals *in situ* will lease to a potential producer the right to extract such minerals. This right is known as a working interest. A royalty is an unencumbered share or fractional interest in the gross production of such working interest. A lessor's royalty is a royalty granted to (or reserved by) the initial lessor. An overriding royalty or a gross overriding royalty is a royalty granted normally by the owner of a working interest to a third party in exchange for consideration which could include, but is not limited to, money or services (e.g., drilling or geological surveying). G. J. Davies, "The Legal Characterization of Overriding Royalty Interests in Oil and Gas" (1972), 10 *Alta. L. Rev.* 232, at p. 233. The rights and obligations of the two types of royalties are identical. The only difference is to whom the royalty was initially granted.

3 The appellant Bank of Montreal was a secured creditor of Dynex Petroleum Ltd. ("Dynex"), a corporation in liquidation. The trustee in bankruptcy wanted to sell all the oil and gas properties of Dynex. One issue was whether any such sale would be subject to overriding royalties arising out of the working interest held by Dynex. Also, there were several competing claims against the appellant, which by the time of this appeal had narrowed to the overriding royalties of the respondents Enchant and Willness, who claimed a preference by way of a caveat filed in the South Alberta Land Registration District, claiming an interest in Dynex's working interest as a result of services performed for Dynex and/or its predecessors. The respondents claimed their royalty rights comprised interests in land and claimed priority over the appellant because their interests, as protected by caveats, preceded the appellant's loans to Dynex and its predecessors. The appellant submitted that at common law an interest in land could not arise from an incorporeal hereditament and therefore the respondents' overriding royalties (which arose from a working interest, an incorporeal hereditament) did not rank higher in priority than the appellant's security interest.

4 This case pits this ancient common law rule against a common practice in the oil and gas industry. The Court is asked to resolve the apparent conflict.

III. Judicial History

5 The appellant applied to the Court of Queens Bench of Alberta ((1995), 39 Alta. L.R. (3d) 66 (Alta. Q.B.)) for a preliminary determination that the overriding royalty interests do not constitute interests in land. The learned chambers judge, Rooke J. in allowing the application held at para. 3 that:

> ... as a matter of law, a lessee of an oil and gas lease (which is a profit à prendre), which is in itself an interest in land, obtained from a lessor (whether the Crown or freehold), cannot in law pass on an interest in land to a third party.

He also concluded that if an interest in land could issue from a *profit à prendre*, which he held that it could not, the matter could not be determined summarily as evidence would be necessary to examine the language of the instruments and the intentions of the parties.

6 After a review of policy considerations, industry practice and Canadian and United States case law, the Alberta Court of Appeal ((1999), 74 Alta. L.R. (3d) 219 (Alta. C.A.)) concluded that overriding royalty interests can constitute interests in land if intended by the parties. For substantially the same reasons as the Court of Appeal, I conclude that overriding royalty interests can be interests in land.

IV. Issue

7 Can an overriding royalty issued from a working interest (an incorporeal hereditament) be an interest in land?

V. Analysis

8 At common law, an interest in land could issue from a corporeal hereditament but not from an incorporeal hereditament. 'Corporeal hereditament' is defined by *The Dictionary of Canadian Law* (2nd ed., 1995) as:

> 1. A material object in contrast to a right. It may include land, buildings, minerals, trees or fixtures. ...
>
> 2. Land.

'Incorporeal hereditament' is defined as:

> 1. "[A right] ... in land, which [includes] such things as rent charges, annuities, easements, profits à prendre, and so on."...
>
> 2. Property which is not tangible but can be inherited.

9 In *Berkheiser v. Berkheiser*, [1957] S.C.R. 387 (S.C.C.), at p. 392, Rand J. held that an oil and gas lease, the interest from which an overriding **royalty** is created, can be a *profit à prendre*, an interest in land. A *profit à prendre* is an incorporeal hereditament. The appellant has submitted that at common law, an interest in land could not issue from an incorporeal hereditament and therefore overriding **royalties** cannot be interests in land.

10 Canadian case law suggests otherwise. In *Saskatchewan Minerals v. Keyes* (1971), [1972] S.C.R. 703 (S.C.C.), the majority declined to decide whether an overriding **royalty** could be an interest in land. However, Laskin J. in dissent specifically addressed that issue. He did not find the distinction between corporeal and incorporeal hereditaments to be useful in this context and discussed the difficulty of conforming new commercial concepts to anachronistic categories at p. 722:

> The language of "corporeal" and "incorporeal" does not point up the distinction between the legal interest and its subject-matter. On this distinction, all legal interests are "incorporeal", and it is only the unconfronted force of a long history that makes it necessary in this case to examine certain institutions of property in the common law provinces through an antiquated system of classification and an antiquated terminology. The association of rents and **royalties** has run through the cases (as in *Re Dawson and Bell, supra*, the *Berkheiser* case, *supra*, and cf. *Attorney-General of Ontario v. Mercer*, at p.777) but without the necessity hitherto in this Court to test them against the common law classifications of interests in land or to determine whether those classifications are broad enough to embrace a **royalty** in gross.

11 Laskin J. referred to *Berkheiser*, *supra*, where Rand J. held that a **royalty** was analogous to rent. While that case involved a lessor's **royalty**, Laskin J. found that although theoretically the holder of a lessor's **royalty** holds an interest in reversion, whereas the holder of an overriding **royalty** does not, since in essence the two interests are identical, there should be no distinction between the two **royalty** interests in their treatment as interests in land. The effect of Laskin J.'s reasons was to render inapplicable, at least insofar as overriding **royalties**, the common law rule against creating interests in land out of incorporeal interests.

12 Laskin J. concluded that the overriding **royalty** was an interest in land, analogous to a rent-charge. It is significant that he did not find all overriding **royalty** interests to be interests in land. He held that the intentions of the parties judged by the language creating the **royalty** would determine whether the parties intended to create an interest in land or to create contractual rights only.

13 In *Scurry-Rainbow Oil Ltd. v. Galloway Estate* (1993), 138 A.R. 321 (Alta. Q.B.), aff'd (1994), 157 A.R. 65 (Alta. C.A.), and in *Canco Oil & Gas Ltd. v. Saskatchewan* (1991), 89 Sask. R. 37 (Sask. Q.B.), Hunt J. and Matheson J. respectively relied upon the dissent in *Keyes*, *supra*, to find that lessor **royalties** can be interests in land depending on the intentions of the parties and the language used to create the interest. The Court of Appeal in *Scurry-Rainbow* did not base its decision on this issue.

14 The appellant referred to cases that held **royalty** interests not to be interests in land. (See *St. Lawrence Petroleum v. Bailey Selburn Oil & Gas Ltd.*, [1963] S.C.R. 482 (S.C.C.); *Vanguard Petroleums Ltd. v. Vermont Oil & Gas Ltd.*, [1977] 2 W.W.R. 66 (Alta. T.D.); *Isaac v. Cook* (1982), 44 C.B.R. (N.S.) 39 (N.W.T. S.C.); *Guaranty Trust Co. of Canada v. Hetherington* (1987), 50 Alta. L.R. (2d) 193 (Alta. Q.B.), aff'd in part [1989] 5 W.W.R. 340 (Alta. C.A.); *Vandergrift v. Coseka Resources Ltd.* (1989), 67 Alta. L.R. (2d) 17 (Alta. Q.B.); *Nova Scotia Business Capital Corp. v. Coxheath Gold Holdings Ltd.* (1993), 128 N.S.R. (2d) 118 (N.S. S.C.).) Although each of these cases held that the **royalty** therein is not an interest in land, they do not support the proposition that a **royalty** cannot be an interest in land. In each case the court found that the language used by the parties in creating the interest did not evidence the intention to create an interest in land.

15 That **royalties** can be interests in land finds support in W. H. Ellis' "Property Status of **Royalties** in Canadian Oil and Gas Law" (1984), 22 *Alta. L. Rev.* 1 at p. 10:

> **Royalties**, as used in the oil and gas industry, make sense only if they are property interests in unproduced minerals. Owners of **mineral rights** should be able to create them as such if they make clear their intent to do so.

16 In *Oil and Gas Agreements Update* (1989), J. F. Newman in his article "Can a Gross Overriding **Royalty** Be an Interest in Land?"concludes that most parties to an overriding **royalty** interest intend for such interest to be an interest in land. Evidence of this is the common practice of registering caveats in the Land Titles Office of Alberta seeking to protect that interest.

17 The oil and gas industry, which developed largely in the second half of the 20th century and continues to evolve, is governed by a combination of statute and common law. The application of common law concepts to a new or developing industry is useful as it provides the participants in the industry and the courts some framework for the legal structure of the industry. It should come as no surprise that some common law concepts, developed in different social, industrial and legal contexts, are inapplicable in the unique context of the industry and its practices.

18 The appellant could not offer any convincing policy reasons for maintaining the common law prohibition on the creation of an interest in land from an incorporeal hereditament other than fidelity to common law principles. Given the custom in the oil and gas industry and the support found in case law, it is proper and reasonable that the law should acknowledge that an overriding **royalty** interest can, subject to the intention of the parties, be an interest in land.

19 The Alberta Court of Appeal offered compelling insight into the evolution of the law at para. 52:

> The principles inherent in the above argument need not be applied to prevent an overriding **royalty** from being an interest in land for a number of reasons. First, **royalties** and ORRs need not be classified into a traditional common law property category unsuited to the realities of the oil and gas industry and need not be subject to the arcane strictures of traditional categories. Second, some authorities suggest it is possible to have an incorporeal interest (an overriding **royalty**) created from an incorporeal interest. Third, even if it is not possible, the rule need not be blindly adhered to because, as stated by Mr. Justice Holmes in "The Path of the Law" (1897) 10 Harv. L. Rev. 457 at p. 469, it is "revolting to have no better reason for a rule of law than that so it was laid down in the time of Henry IV," and, "still more revolting if the grounds upon which it was laid down have vanished long since, and the rule persists from blind imitation of the past."

20 In *Friedmann Equity Developments Inc. v. Final Note Ltd.*, [2000] 1 S.C.R. 842, 2000 SCC 34 (S.C.C.), at para. 42, Bastarache J. outlined when changes to the rules of common law are necessary:

> (1) to keep the common law in step with the evolution of society,
>
> (2) to clarify a legal principle, or
>
> (3) to resolve an inconsistency.

In addition, the change should be incremental, and its consequences must be capable of assessment.

21 In this appeal, to clarify the status of overriding **royalties**, the prohibition of the creation of an interest in land from an incorporeal hereditament is inapplicable. A **royalty** which is an interest in land may be created from an incorporeal hereditament such as a working interest or a *profit à prendre*, if that is the intention of the parties.

22 Virtue J. in *Vandergrift* , *supra*, at p. 26 succinctly stated:

> ... it appears reasonably clear that under Canadian law a "**royalty** interest" or an "overriding **royalty** interest" can be an interest in land if:
>
> 1) 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 oil and gas substances recovered from the land; and
>
> 2) the interest, out of which the **royalty** is carved, is itself an interest in land.

VI. Conclusion

23 The appeal is dismissed with costs to the respondents.

***Major J.*:**

I. Introduction

1 Le présent pourvoi vise une demande que la Banque de Montréal, appelante, a présentée à un juge de la Cour du Banc de la Reine de l'Alberta siégeant en chambre afin qu'il statue, en droit, qu'une redevance dérogatoire ne peut constituer un intérêt foncier. Plusieurs défendeurs se sont opposés à la demande. Au nombre des opposants figuraient les intimés devant notre Cour, Enchant Resources Ltd. (« Enchant ») et D.S. Willness (« Willness »), titulaires de redevances dérogatoires qui prétendaient détenir un intérêt foncier. Le juge a fait droit à la demande de la Banque. La Cour d'appel de l'Alberta a infirmé cette décision, statuant qu'une redevance dérogatoire peut être un intérêt foncier. Notre Cour a rejeté le pourvoi, avec motifs à suivre.

II. Les faits

2 Les pièces produites et les plaidoiries des avocats révèlent que les arrangements en matière de redevances sont de pratique courante en Alberta dans le secteur de l'exploration et de la production pétrolières et gazières. D'ordinaire, le propriétaire des minéraux *in situ* donne à bail à un producteur potentiel le droit d'extraire ces minéraux. Pour désigner ce droit, on utilise l'expression « participation directe ». Une redevance est une part ou participation fractionnaire non grevée dans la production brute issue de cette participation directe. La redevance du bailleur est une redevance accordée au bailleur initial (ou qu'il se réserve). Une redevance dérogatoire ou redevance dérogatoire brute est une redevance accordée normalement par le titulaire d'une participation directe à un tiers en échange d'une contrepartie qui peut comprendre notamment une somme d'argent ou des services (par exemple, le forage ou les études géologiques). G. J. Davies, « The Legal Characterization of Overriding **Royalty** Interests in Oil and Gas » (1972), 10 *Alta. L. Rev.* 232, p. 233. Les mêmes droits et obligations se rattachent aux deux types de redevance. Seul les différencie le fait que la redevance n'est pas accordée initialement à la même personne.

3 La Banque de Montréal, appelante, était un créancier garanti de Dynex Petroleum Ltd. (« Dynex »), société en voie de liquidation. Le syndic de faillite voulait vendre tous les avoirs gaziers et pétroliers de Dynex. La question se posait donc de savoir si la vente serait conclue sous réserve des redevances dérogatoires provenant de la participation directe détenue par Dynex. De plus, l'appelante se voyait opposer plusieurs réclamations concurrentes dont ne subsistaient plus, au moment du présent pourvoi, que les redevances dérogatoires des intimés Enchant et Willness, qui revendiquaient un

rang prioritaire en invoquant une opposition déposée au bureau d'enregistrement foncier du district du sud de l'Alberta, faisant valoir un intérêt dans la participation directe détenue par Dynex par suite de la fourniture de services à Dynex ou à ses prédécesseurs. Les intimés soutenaient que leurs droits de redevance comportaient des intérêts fonciers et prétendaient prendre rang avant l'appelante parce que leurs intérêts protégés par les oppositions étaient antérieurs aux prêts consentis par l'appelante à Dynex et à ses prédécesseurs. L'appelante a soutenu que, en common law, un intérêt foncier ne pouvait dériver d'un héritage incorporel et que, partant, les redevances dérogatoires des intimés (dérivées d'une participation directe et, donc, d'un héritage incorporel) ne prenaient pas rang avant la sûreté qu'elle détenait.

4 La présente affaire oppose cette ancienne règle de common law et une pratique courante du secteur pétrolier et gazier. La Cour est appelée à trancher ce conflit apparent.

III. Historique des procédures judiciaires

5 L'appelante a demandé à la Cour du Banc de la Reine de l'Alberta ((1995), 39 Alta. L.R. (3d) 66) de statuer, par une décision préliminaire, que les droits de redevance dérogatoire ne constituaient pas des intérêts fonciers. Le juge Rooke siégeant en chambre a fait droit à la demande en ces termes, au par. 3 :

> [TRADUCTION] ... en droit, le preneur à bail d'une concession pétrolière et gazière (qui est un profit à prendre), qui est en soi un intérêt foncier, obtenue d'un bailleur (location de la Couronne ou location à bail franche), ne peut, en common law, transmettre un intérêt foncier à un tiers.

Il a également conclu que, si un intérêt foncier pouvait dériver d'un profit à prendre — solution qu'il a écartée — , la question ne pourrait être tranchée sommairement, car une preuve serait nécessaire aux fins de l'examen des termes des instruments et de l'intention des parties.

6 Après avoir examiné les considérations de principe, la pratique du secteur d'activité en cause et la jurisprudence canadienne et américaine, la Cour d'appel de l'Alberta ((1999), 74 Alta. L.R. (3d) 219) a conclu que les droits de redevance dérogatoire pouvaient constituer des intérêts fonciers si telle était l'intention des parties. M'appuyant essentiellement sur les mêmes motifs que la Cour d'appel, je suis d'avis que les droits de redevance dérogatoire peuvent constituer des intérêts fonciers.

IV. La question en litige

7 Une redevance dérogatoire issue d'une participation directe (un héritage incorporel) peut-elle constituer un intérêt foncier?

V. Analyse

8 En common law, un intérêt foncier pouvait être issu d'un héritage corporel, mais non d'un héritage incorporel. Dans le *Dictionary of Canadian Law* (2e éd., 1995), la notion de « *corporeal hereditament* » (héritage corporel) est définie comme suit :

> [TRADUCTION]
>
> 1. Chose matérielle par contraste avec un droit. Peut s'entendre de fonds de terre, bâtiments, minéraux, arbres ou accessoires fixes. ...
>
> 2. Fonds de terre.

L'expression « *incorporeal hereditament* » (héritage incorporel) est définie comme suit :

> [TRADUCTION]

1. « [Droit] ... sur un fonds de terre, qui [inclut] des choses telles que les rentes-charges, annuités, servitudes, profits à prendre, etc. » ...

2. Bien qui n'est pas matériel, mais peut être transmis par voie héréditaire.

9 Dans *Berkheiser c. Berkheiser*, [1957] R.C.S. 387, p. 392, le juge Rand a décidé qu'une concession pétrolière et gazière, l'intérêt dont est issue une redevance dérogatoire, peut être un profit à prendre, un intérêt foncier. Un profit à prendre est un héritage incorporel. L'appelante a prétendu que, en common law, un intérêt foncier ne pouvait être issu d'un héritage incorporel et que, par conséquent, les redevances dérogatoires ne pouvaient pas constituer des intérêts fonciers.

10 La jurisprudence canadienne semble indiquer le contraire. Dans *Saskatchewan Minerals c. Keyes*, [1972] R.C.S. 703, la Cour suprême à la majorité s'est abstenue de décider si une redevance dérogatoire pouvait constituer un intérêt foncier. Toutefois, le juge Laskin, dissident, s'est intéressé précisément à cette question. Il n'a pas jugé la distinction entre les héritages corporels et incorporels utile dans ce contexte et il a traité de la difficulté de concilier les concepts modernes du commerce et les catégories anachroniques à la p. 722 :

> Les expressions « corporel » et « incorporel » ne font pas ressortir la distinction entre l'intérêt en droit et l'objet auquel il se rattache. D'après cette distinction tous les intérêts en droit sont « incorporels », et c'est l'autorité jamais attaquée d'une longue évolution historique qui nous oblige ici à étudier certaines institutions de la propriété dans les provinces régies par la *common law* au moyen d'un système de classification suranné et d'une terminologie surannée. Les rentes et les redevances ont été associées dans la jurisprudence (par exemple, dans les cause *Re Dawson and Bell* et *Berkheiser*, précitées; voir aussi *Attorney General of Ontario v. Mercer*, p. 777), mais jusqu'à maintenant, cette Cour n'a jamais eu à les analyser en regard de la classification des intérêts dans un bien-fonds en *common law*, ni à déterminer si cette classification est assez générale pour englober une redevance existant par elle-même.

11 Le juge Laskin s'est reporté à la décision *Berkheiser*, précitée, où le juge Rand a décidé qu'une redevance était assimilable à une rente. Bien que cette affaire ait porté sur une redevance de bailleur, le juge Laskin a estimé que, même si en théorie le titulaire d'une redevance de bailleur détient un intérêt de réversion, ce qui n'est pas le cas du titulaire d'une redevance dérogatoire, il n'y avait pas lieu de faire de distinction entre ces deux redevances dans l'effet qui leur est attribué à titre d'intérêts fonciers, puisque les deux intérêts sont essentiellement identiques. Les motifs du juge Laskin ont eu pour effet de rendre inapplicable, du moins quant aux redevances dérogatoires, la règle de common law interdisant la création d'intérêts fonciers à partir d'intérêts incorporels.

12 Le juge Laskin a conclu que la redevance dérogatoire était un intérêt foncier, analogue à une rente-charge. Il est significatif qu'il n'ait pas jugé que toutes les redevances dérogatoires étaient des intérêts fonciers. Il a estimé que les intentions des parties révélées par les termes du contrat de redevance permettraient de décider si les parties avaient l'intention de créer un intérêt foncier ou uniquement des droits contractuels.

13 Dans *Scurry-Rainbow Oil Ltd. c. Galloway Estate* (1993), 138 A.R. 321 (B.R.), conf. (1994), 157 A.R. 65 (C.A.), et dans *Canco Oil and Gas Ltd. c. Saskatchewan* (1991), 89 Sask. R. 37 (B.R.), les juges Hunt et Matheson, respectivement, se sont fondés sur l'opinion dissidente exprimée dans *Keyes*, précité, pour conclure que les redevances de bailleur pouvaient être des intérêts fonciers selon les intentions des parties et les termes employés pour créer l'intérêt. La Cour d'appel dans *Scurry-Rainbow* n'a pas fondé sa décision sur cette question.

14 L'appelante a cité des décisions où il a été jugé que des droits de redevance n'étaient pas des intérêts fonciers. (Voir *St. Lawrence Petroleum Ltd. c. Bailey Selburn Oil & Gas Ltd.*, [1963] R.C.S. 482; *Vanguard Petroleums Ltd. c. Vermont Oil & Gas Ltd.*, [1977] 2 W.W.R. 66 (C.S. Div. instr. Alb.); *Isaac c. Cook* (1982), 44 C.B.R. 39 (C.S.T.N-O.); *Guaranty Trust Co. c. Hetherington* (1987), 50 Alta. L.R. (2d) 193 (B.R.), conf. en partie [1989] 5 W.W.R. 340 (C.A. Alb.); *Vandergrift c. Coseka Resources Ltd.* (1989), 67 Alta. L.R. (2d) 17 (B.R.); *Nova Scotia Business Capital Corp. c. Coxheath Gold Holdings Ltd.* (1993), 128 N.S.R. (2d) 118 (C.S.).) Bien que dans toutes ces décisions, il ait été statué que la redevance en cause n'était pas un intérêt foncier, elles ne permettent pas d'affirmer qu'une redevance ne peut jamais

être un intérêt foncier. Dans chacune, la cour a conclu que les termes employés par les parties pour créer l'intérêt ne révélaient pas l'intention de créer un intérêt foncier.

15 La thèse selon laquelle les redevances peuvent constituer des intérêts fonciers est étayée par l'article de W.H. Ellis, « Property Status of **Royalties** in Canadian Oil and Gas Law » (1984), 22 *Alta. L. Rev.* 1, p. 10 :

> [TRADUCTION]
>
> Les redevances, telles qu'utilisées dans le secteur des hydrocarbures, **n'ont** de sens que si elles constituent des intérêts de propriété dans les minéraux non encore produits. Les titulaires des droits miniers doivent pouvoir créer de tels intérêts, s'ils précisent clairement que telle est leur intention.

16 Dans l'article intitulé « Can a Gross Overriding **Royalty** Be an Interest in Land? », publié dans *Oil & Gas Agreements Update* (1989), J. F. Newman conclut que, la plupart du temps, il est de l'intention des parties à un contrat de redevance dérogatoire que le droit de redevance constitue un intérêt foncier. En fait foi la pratique courante qui consiste à enregistrer des oppositions au bureau d'enregistrement des titres fonciers de l'Alberta afin de protéger ces intérêts.

17 Le secteur des hydrocarbures, qui s'est développé en grande partie dans la seconde moitié du XX^{e} siècle et continue d'évoluer, est régi par un ensemble de lois et de règles de common law. L'application des notions de common law à une industrie nouvelle ou en évolution est utile, car elle fournit aux intervenants de l'industrie et aux tribunaux un cadre juridique à l'intérieur duquel structurer les activités de ce secteur. Il n'est guère étonnant que certaines notions de common law élaborées dans des contextes sociaux, industriels et juridiques différents soient inapplicables dans le contexte particulier de ce secteur d'activité et de ses pratiques.

18 L'appelante n'a pu invoquer aucune raison de principe convaincante justifiant le maintien de la règle de common law qui interdit la création d'un intérêt foncier à partir d'un héritage incorporel, si ce n'est la fidélité aux principes de common law. Étant donné, d'une part, la coutume dans le secteur des hydrocarbures et, d'autre part, l'appui fourni par la jurisprudence, il est opportun et raisonnable que la loi reconnaisse qu'un droit de redevance dérogatoire peut constituer un intérêt foncier, à condition que telle soit l'intention des parties.

19 La Cour d'appel de l'Alberta nous offre des réflexions convaincantes sur l'évolution du droit, au par. 52 :

> [TRADUCTION]
>
> Il n'est pas nécessaire d'appliquer les principes qui se dégagent de l'argument précité pour empêcher qu'une redevance dérogatoire ne constitue un intérêt foncier, et ce pour plusieurs raisons. D'abord, il n'est pas nécessaire de classer les redevances et les redevances dérogatoires dans les catégories classiques du droit des biens en common law qui ne s'accordent pas avec les réalités du secteur pétrolier et gazier, ni de les assujettir aux définitions ésotériques des catégories classiques. Ensuite, certaines sources semblent indiquer qu'il est possible qu'un intérêt incorporel (une redevance dérogatoire) soit créé à partir d'un intérêt incorporel. Enfin, même si cela n'était pas possible, nous ne serions pas tenus de suivre la règle aveuglément, puisque, pour reprendre les propos du juge Holmes dans « The Path of the Law » (1897) 10 *Harv. L. Rev.* 457, p. 469, il est « choquant que la valeur d'une règle de droit ne tienne qu'à son ancienneté, dût-elle remonter à Henri IV », et « encore plus choquant que son fondement ait disparu depuis longtemps, mais qu'elle subsiste en raison d'un passéisme aveugle. »

20 Dans *Friedmann Equity Developments Inc. c. Final Note Ltd.*, [2000] 1 R.C.S. 842, 2000 CSC 34, au par. 42, le juge Bastarache a mis en lumière les cas où une modification de la common law sera nécessaire :

> (1) pour permettre à la common law de suivre l'évolution de la société;
>
> (2) pour préciser un principe de droit;
>
> (3) pour éliminer une contradiction.

De plus, la modification doit être graduelle et ses conséquences doivent pouvoir être évaluées.

21 Dans le présent pourvoi, pour préciser le droit en matière de redevances dérogatoires, l'interdiction de créer un intérêt foncier à partir d'un héritage incorporel est inapplicable. Une redevance qui est un intérêt foncier peut être créée à partir d'un héritage incorporel tel qu'une participation directe ou un profit à prendre, si telle est l'intention des parties.

22 Dans *Vandergrift*, précité, à la p. 26, le juge Virtue dit succinctement :

> [TRADUCTION] ... il semble assez clair que, selon le droit canadien, un droit de redevance ou un droit de redevance dérogatoire peut être un intérêt foncier si les conditions suivantes sont réunies :
>
> 1) les termes employés pour décrire l'intérêt sont suffisamment précis pour démontrer l'intention des parties que la redevance constitue un intérêt foncier, plutôt qu'un droit contractuel sur une fraction des hydrocarbures extraits du sol;
>
> 2) l'intérêt dont est issue la redevance est lui-même un intérêt foncier.

IV. Conclusion

23 Le pourvoi est rejeté avec dépens en faveur des intimés.

Order accordingly.

Ordonnance en conséquence.

End of Document

2

1999 ABCA 363
Alberta Court of Appeal

Bank of Montreal v. Dynex Petroleum Ltd.

1999 CarswellAlta 1271, 1999 ABCA 363, [1999] A.J. No. 1463, [2000] 2 W.W.R. 693, [2000] A.W.L.D. 151, 15 C.B.R. (4th) 5, 15 P.P.S.A.C. (2d) 179, 182 D.L.R. (4th) 640, 220 W.A.C. 116, 255 A.R. 116, 2 B.L.R. (3d) 58, 2 B.L.R. (3d) 59, 74 Alta. L.R. (3d) 219, 93 A.C.W.S. (3d) 950

Bank of Montreal, Respondent (Plaintiff) and Enchant Resources Ltd., and D.S. Willness, Appellants (Defendants) and Dynex Petroleum Ltd., Alberta Energy Company Ltd., Ardmore Investments Ltd., Transcanada Pipelines Ltd., Amoco Canada Petroleum Ltd., Atcor Ltd., Crestar Energy Inc., Dana Distributors Ltd., Vimyview Ltd., Col-Syb Holdings Ltd., Hexam Holdings Ltd., Davids Investments Ltd., Edward W. Hadway, Estate of Harry Veiner, Victor Sopkiw, Nancy Oil & Gas Ltd., Staniloff Oil & Gas Ltd., Cory Oils Ltd., Doran Investments Ltd., Encor Energy Corporation Inc., Epic Resources Ltd., Kirriemuir Resources Ltd., Meridian Oil Inc., North Canadian Oils Limited, Odessa Natural Corporation, Precambrian Shield Resources Limited, Star Oil and Gas Ltd., Suncor Inc., Earl Gordon, Antelope Land Serves Ltd., Brannigan Resources Canada (1992) Ltd., Jim Bruce Consultants, Saskatchewan Oil and Gas Corporation, Sask Oil Resources Inc., Landsea Oil & Gas Ltd., Intensity Resources Ltd., Deane Enterprises Ltd., Shell Canada Resources Ltd., Channel Lake Petroleum Ltd., and Enron Oil Canada Ltd., Defendants not Party to the Appeal

Bank of Montreal, Appellant (Plaintiff) and Meridian Oil Inc., Odessa Natural Corporation, Enchant Resources Ltd., and D.S. Willness, (Respondents) Defendants and Dynex Petroleum Ltd., Alberta Energy Company Ltd., Ardmore Investments Ltd., Transcanada Pipelines Ltd., Amoco Canada Petroleum Ltd., Atcor Ltd., Crestar Energy Inc., Dana Distributors Ltd., Vimyview Ltd., Col-Syb Holdings Ltd., Hexam Holdings Ltd., Davids Investments Ltd., Edward W. Hadway, Estate of Harry Veiner, Victor Sopkiw, Nancy Oil & Gas Ltd., Staniloff Oil & Gas Ltd., Cory Oils Ltd., Doran Investments Ltd., Encor Energy Corporation Inc., Epic Resources Ltd., Kirriemuir Resources Ltd., North Canadian Oils Limited, Precambrian Shield Resources Limited, Star Oil and Gas Ltd., Suncor Inc., Earl Gordon, Antelope Land Services Ltd., Brannigan Resources Canada (1992) Ltd., Jim Bruce Consultants, Saskatchewan Oil and Gas Corporation, Sask Oil Resources Inc., Landsea Oil & Gas Ltd., Intensity Resources Ltd., Deane Enterprises Ltd., Shell Canada Resources Ltd., Enron Oil Canada Ltd. and Channel Lake Petroleum Ltd., Defendants

Bank of Montreal, Appellant (Plaintiff) and Meridian Oil Inc., Odessa Natural Corporation, Enchant Resources Ltd., and D.S. Willness, (Respondents) Defendants and Dynex Petroleum Ltd., Alberta Energy Company Ltd., Ardmore Investments Ltd., Transcanada Pipelines Ltd., Amoco Canada Petroleum Ltd., Atcor Ltd., Crestar Energy Inc., Dana Distributors Ltd., Vimyview Ltd., Col-Syb Holdings Ltd., Hexam Holdings Ltd., Davids Investments Ltd., Edward W. Hadway, Estate of Harry Veiner, Victor Sopkiw, Nancy Oil & Gas Ltd., Staniloff Oil & Gas Ltd., Cory Oils Ltd., Doran Investments Ltd., Encor Energy Corporation Inc., Epic Resources Ltd., Kirriemuir Resources Ltd., North Canadian Oils Limited, Precambrian Shield Resources Limited, Star Oil and Gas Ltd., Suncor Inc., Earl Gordon, Antelope Land Services Ltd., Brannigan Resources Canada (1992) Ltd., Jim Bruce Consultants, Saskatchewan Oil and Gas Corporation, Sask Oil Resources Inc., Landsea Oil & Gas Ltd., Intensity Resources Ltd., Deane Enterprises Ltd., Shell Canada Resources Ltd., Enron Oil Canada Ltd. and Channel Lake Petroleum Ltd., Defendants (Not Parties to this Appeal)

Foisy, Berger, Sulatycky JJ.A.

Heard: November 30, December 1 and 2, 1998
Judgment: December 17, 1999
Docket: Calgary Appeal 96-16526, 96-16536, 97-17211

Proceedings: reversing (1995), 35 Alta. L.R. (3d) 66 (Alta. Q.B.); reversing (1997), 50 Alta. L.R. (3d) 44 (Alta. Q.B.)

Counsel: *G.S. Griffiths, Q.C.* and *R.B. Jones*, for Bank of Montreal.
J.C. Crawford, Q.C., for Enchant Resources Ltd. and D.S. Willness.
R.C. Dixon, for Ernst & Young Inc., Trustee in **Bankruptcy** of Dynex Petroleum Ltd.

Subject: Natural Resources; Property; Corporate and Commercial; Insolvency

Headnote

Oil and gas --- Exploration and operating agreements — Royalty agreement — General

Defendant D Ltd. granted overriding **royalty** and net profit interests to other defendants with respect to D Ltd's oil and gas leases, and granted debenture to bank, employing gas leases as security — On **bankruptcy** of D. Ltd., bank sought declaration that it had priority over parties holding overriding **royalties** and net profits interests — Chambers judge found ORRs were choses in action and not real property interest, that they were subject to personal property security legislation, that they were unsecured and thus subject to trustee's taking — ORRs holders appealed — Appeal allowed — Parties can create overriding **royalties** that constitute interests in land if they manifest their intention to do so.

Personal property security --- Scope of legislation — Miscellaneous transactions

Defendant D Ltd. granted overriding **royalty** and net profit interests to other defendants with respect to D Ltd's oil and gas leases, and granted debenture to bank, employing gas leases as security — On **bankruptcy** of D. Ltd., bank sought declaration that it had priority over parties holding overriding **royalties** and net profits interests — Chambers judge found ORRs were choses in action and not real property interest, that they were subject to personal property security legislation, and that they were unsecured and thus subject to trustee's taking — ORRs holders appealed — Appeal allowed — Parties can create overriding **royalties** that constitute interests in land if they manifest their intention to do so.

Oil and gas --- Oil and gas lease — Miscellaneous issues

Defendant D Ltd. granted overriding **royalty** and net profit interests to other defendants with respect to D Ltd's oil and gas leases, and granted debenture to bank, employing gas leases as security — On **bankruptcy** of D. Ltd., bank sought declaration that it had priority over parties holding overriding **royalties** and net profits interests — Chambers judge found ORRs were choses in action and not real property interest, that they were subject to personal property security legislation, that they were unsecured and thus subject to trustee's taking — ORRs holders appealed — Appeal allowed — Parties can create overriding **royalties** that constitute interests in land if they manifest their intention to do so.

The defendant D Ltd. and its predecessor companies granted overriding **royalty** and net profit interests ("ORRs") respecting D Ltd.'s oil and gas leases to other defendants. Later, D Ltd. gave a debenture to the plaintiff bank, employing the leases as security. All of the documentation supporting the debenture stated that the ORR interests were permitted encumbrance. D Ltd. later defaulted on the bank loan. Shortly thereafter, D Ltd. was petitioned into **bankruptcy**. The bank brought an action against the bankrupt and the ORRs, seeking a declaration that the bank's claim ranked in priority to those of the ORRs in the context of the **bankruptcy**. All the parties requested a determination of the priorities between the bank and the ORRs after the **bankruptcy**.

The chambers judge found that the ORRs were choses in action and did not constitute interests in land. As a matter of law, he found that a lessee of an oil and gas lease obtained from a lessor could not pass an interest in land to a third party. Based on this conclusion that ORRs were not interests in land, the chambers judge went on to make determinations respecting priority of the bank's debenture vis-à-vis the ORRs, and the effect of **bankruptcy** on such priority determinations.

The ORRs holders appealed.

Held: The appeal was allowed.

Parties can create overriding **royalties** that constitute interests in land if they manifest their intention to do so. Some indicia of whether or not a creation of an interest in land is intended may be the fact that the underlying interest is an interest in land, the intention of the parties as evidenced by the language of the grant and surrounding circumstances, and that the interest is capable of lasting for the duration of the underlying estate. Other indicia of intention can be found in the wording of the overriding **royalty** clause creating a reservation of an interest in the petroleum substances by the farmor in the working interest to be earned by the farmee, the farmee as agent of the farmor for the farmor's share of petroleum production, and remedies against the interest of the farmee through a lien.

Having found that ORRs may be interests in land depending on the agreement between parties, a final determination of the matter required a finding of fact. Therefore, issues respecting priority of bank's debenture security interests vis-à-vis ORRs, and the effect of **bankruptcy** on such priority determinations were to be determined at trial along with the issue of whether the ORRs were, in fact, interests in land.

Table of Authorities

Cases considered:

Anderson v. Amoco Canada Oil & Gas (1998), 63 Alta. L.R. (3d) 1, 225 A.R. 277, [1999] 3 W.W.R. 255 (Alta. Q.B.) — considered

Berkheiser v. Berkheiser, [1957] S.C.R. 387, 7 D.L.R. (2d) 721 (S.C.C.) — considered

Callahan v. Martin (1932), 3 Cal. 2d 110, 43 P.2d 788, 101 A.L.R. 871 (U.S. Cal.) — considered

Canco Oil & Gas Ltd. v. Saskatchewan, 89 Sask. R. 37, [1991] 4 W.W.R. 316 (Sask. Q.B.) — applied

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Panamericana de Bienes y Servicios S.A. v. Northern Badger Oil & Gas Ltd. (1989), 75 Alta. L.R. (2d) 185, 80 C.B.R. (N.S.) 84 (Alta. Q.B.) — referred to

Panamericana de Bienes y Servicios S.A. v. Northern Badger Oil & Gas Ltd., 8 C.B.R. (3d) 31, 81 Alta. L.R. (2d) 45, [1991] 5 W.W.R. 577, 81 D.L.R. (4th) 280, 7 C.E.L.R. (N.S.) 66, 117 A.R. 44, 2 W.A.C. 44 (Alta. C.A.) — referred to

Panamericana de Bienes y Servicios S.A. v. Northern Badger Oil & Gas Ltd. (1992), 8 C.B.R. (3d) 31n, 7 C.E.L.R. (N.S.) 66n, 83 Alta. L.R. (2d) lxvi, 86 D.L.R. (4th) 567n, 137 N.R. 394, 127 A.R. 396, 20 W.A.C. 396, 3 C.P.C. (3d) 100n (S.C.C.) — referred to

Publix Oil & Gas Ltd., Re, 18 C.B.R. 331, [1936] 3 W.W.R. 634, [1937] 1 D.L.R. 203 (Alta. C.A.) — considered

R. v. Westbrook (1847), 116 E.R. 69, 10 Q.B. 178 (Eng. Q.B.) — considered

Saskatchewan Minerals v. Keyes (1971), [1972] S.C.R. 703, [1972] 2 W.W.R. 108, 23 D.L.R. (3d) 573 (S.C.C.) — considered

Scurry-Rainbow Oil Ltd. v. Galloway Estate, 8 Alta. L.R. (3d) 225, 138 A.R. 321, [1993] 4 W.W.R. 454 (Alta. Q.B.) — applied

Scurry-Rainbow Oil Ltd. v. Galloway Estate (1994), 23 Alta. L.R. (3d) 193, 157 A.R. 65, 77 W.A.C. 65, [1995] 1 W.W.R. 316 (Alta. C.A.) — referred to

Scurry-Rainbow Oil Ltd. v. Galloway Estate, 26 Alta. L.R. (3d) 1 (note), [1995] 4 W.W.R. lxviii (note), 189 N.R. 237 (note), 189 N.R. 238 (note), 178 A.R. 77 (note), 110 W.A.C. 77 (note), 178 A.R. 78 (note), 110 W.A.C. 78 (note) (S.C.C.) — referred to

St. Lawrence Petroleum v. Bailey Selburn Oil & Gas Ltd., [1963] S.C.R. 482, 45 W.W.R. 26, 41 D.L.R. (2d) 316 (S.C.C.) — considered

Statutes considered:

Bank Act, R.S.C. 1985, c. B-1
Generally — referred to

Rules considered:

Alberta Rules of Court, Alta. Reg. 390/68
R. 220 — referred to

R. 221 — referred to

APPEAL by overriding **royalties** and net profit interest holders from judgments reported at (1995), 39 Alta. L.R. (3d) 66, [1996] 6 W.W.R. 461, 11 P.P.S.A.C. (2d) 291 (Alta. Q.B.) and 50 Alta. L.R. (3d) 44, [1997] 6 W.W.R. 104, 31 B.L.R. (2d) 44, 46 C.B.R. (3d) 36, 145 D.L.R. (4th) 499, 202 A.R. 331, 12 P.P.S.A.C. (2d) 183 (Alta. Q.B.), finding that their interests were subject to personal property security legislation and subordinate to interests of trustee in **bankruptcy**.

***Per curiam*:**

Introduction

1 This appeal involves the competing interests of a bank as a debenture holder and parties holding overriding **royalties** and net profits interests from a petroleum and natural gas company now in **bankruptcy**.

2 These matters initially came before the chambers judge pursuant to two notices of motion seeking summary judgment on the issue of priorities between the bank and the overriding **royalty** holders, and a preliminary determination of a point of law prior to trial that the overriding **royalties** do not constitute interests in land binding upon any successor in title

to the petroleum and natural gas properties. After those motions were determined, leave was granted to determine the effect of the **bankruptcy** upon the earlier order.

3 Appeals from each of the three applications before the chambers judge were heard.

Issues

4 The issues argued in this appeal were:

1. Can net profits and overriding **royalty** interests constitute interests in land.

2. If they are not interests in land, are the debenture security interests and similar interests granted to the bank subordinated to the overriding **royalty** interests.

3. If the bank's interests are subordinated to the overriding **royalty** interests, does the **bankruptcy** affect the subordination of the bank's security interest to the overriding **royalty** interests and does the bank continue to be obliged to hold in trust proceeds received prior to the sale of the oil and gas properties.

Summary of Conclusions

5 We conclude that overriding **royalties** or net profits interests can constitute an interest in land. Whether the interests in this appeal are interests in land depends upon the intentions of the parties. We do not make a determination on the second and third issues since their outcome depends upon the determination of the first.

Facts

6 On May 27, 1993, Ernst & Young Inc. ("the Trustee") was appointed trustee in **bankruptcy** of Dynex Petroleum Ltd., previously M-P Petroleum Ltd. ("Dynex") pursuant to the petition of the Bank of Montreal ("the Bank"). The Trustee wanted to sell all the petroleum and natural gas properties of Dynex. One issue was whether those properties must be sold subject to the rights of persons with overriding **royalties** and net profits agreements. Those persons included Enchant Resources Ltd. ("Enchant") and D.S. Willness ("Willness").

7 In August 1993, all the oil and gas properties of Dynex were sold to Channel Lake Petroleum Ltd. minus the proceeds held by the Trustee for payments due to overriding **royalty** interest holders.

The Overriding Royalty Interests

8 The overriding **royalty** interests of Enchant and Willness (collectively referred to as "ORRs") result from various agreements. Enchant held petroleum and natural gas leases of freehold land in southeastern Alberta. It also acquired other leases, including Crown leases.

9 Without going into all the details, these interests were acquired in various ways.

10 One agreement, from 1974, between Enchant and Willness provides that Willness or his successors and assigns be paid a 2 $^{1}/_{2}$% gross overriding **royalty** from and out of the net petroleum substances produced, saved and sold from freehold leases referred to within the agreement. The **royalty** was payment in consideration for Willness' services in introducing Enchant to the holders of the lease.

11 Some other **royalties** were obtained by Enchant through farm out agreements. Various companies successfully drilled wells and parties' rights under the farm out were earned. Dynex later assumed the obligation to pay the overriding **royalties**.

12 As an example, by a 1972 agreement, Enchant purchased petroleum and natural gas leases on freehold land. Enchant filed caveats at the South Alberta Land Registration District registering a "good and valid claim upon the said land".

13 That acreage was part of a farmout by the Hadway Fund Group, which became Dana Distributors Ltd. A 15% gross overriding **royalty** was reserved to Enchant plus a 2 $^{1}/_{2}$% gross overriding **royalty** to Willness.

14 The agreement provided among other things:

> (6) Should additional acreage, other than that mentioned previously, become available either by purchase or farm in, Hadway will supply the necessary funds to acquire and drill the acreage, reserving a 15% gross override to Enchant.
>
> ...
>
> (13) Enchant's override shall be calculated at 15% of the gross value of the gas sold subject only to the deduction of the actual processing and compressing costs.

15 A successful gas well validated the farmout agreement. These and other lands were sold subject to the ORRs, to M-P Petroleum Ltd., which later became Dynex. In an agreement entitled Assignment and Net Profits Agreement, M-P Petroleum Ltd., as assignee of various lands and leases, "did sell, assign, transfer, convey and set over unto the assignee" and did accept the transfer of such lands and did undertake to hold same:

> subject to the assumption by the assignee of the overriding **royalties** burdening the leases and the lands as described and set forth in Part I, II and III of Schedule "A" hereto (hereinafter call the "overriding **royalties**")

16 Enchant was named signatory and assignor under this agreement which set forth both the Enchant and the Willness **royalties**. That agreement also provided that the assignors, including Enchant, also reserved to themselves 40% of the net profits realized by the assignee from the oil and gas produced from the properties assigned and conveyed to the assignee. The agreement further provided that "40% of the net profits" meant "an interest in land entitling the assignors to receive monthly an amount equal to" a percentage as computed by an accounting procedure set out in Schedule "B".

17 Additionally, Enchant's rights to be paid overriding **royalties** by Dynex was documented in four overriding **royalty** agreements. The agreement dated January 22, 1975 provided:

> The Grantor hereby agrees to pay or cause to be paid to the Grantee, an overriding **royalty** of three percent (3%) of the proceeds (subject to the deductions hereinafter referred to) received by the Grantor on the sale of all petroleum substances produced, saved and marketed from the said lands.

The Security Interests of the Bank of Montreal

18 From 1979, and at various times after, the Bank lent money to M-P Petroleum Ltd., then later, Dynex. Securities for the loans included petroleum and natural gas leases, which were assigned pursuant to the *Bank Act*, R.S.C. 1985, c. B-1, and fixed and floating charge debentures.

19 At the time of making the loans and executing the various security agreements, the Bank knew of Dynex's obligations to pay the ORRs. These are noted, for example, in the general assignment between the Bank and M-P Petroleum Ltd. M-P Petroleum covenanted that the property was free of any encumbrances save those set forth in the schedule that included the gross overriding **royalties**.

20 Similarly, for example, in the debenture, Dynex mortgaged and charged, as a first, floating charge in favour of the Bank, all of its undertaking, property and assets subject to the conditions which included any interests of a third party under any pooling, unitization, development, farm out, operating **royalty** or overriding **royalty** agreements as "permitted encumbrances". A similar exception for permitted encumbrances existed in the loan agreement of the same date.

21 On May 26, 1993, the Bank issued a petition pursuant to the BIA seeking a receiving order and gave rise to the further issues of the priority of the ORRs to the Bank's interest and the effect of the **bankruptcy** on the priorities between the ORRs and the Bank.

Judgments Below

22 The chambers judge issued two orders. In his reasons dated December 19, 1995 [reported at 39 Alta. L.R. (3d) 66], he held that overriding **royalties** do not constitute interests in land. As a matter of law, he found that a lessee of an oil and gas lease (which is a *profit à prendre*), which is in itself an interest in land, obtained from a lessor (whether the Crown or freehold), cannot pass an interest in land to a third party. He did not name any particular authorities but stated he was guided by binding authorities in reaching this conclusion. He went on further to say that if it were possible to have an interest in land, it required an examination of the language of the instrument to see if the intention of the parties was to create such an interest. Because this requires a fact finding in each case, it could not be decided on a motion under Rule 220, but had to be determined at trial.

23 On the issue of the priorities of the interests between the Bank and the ORRs prior to the **bankruptcy** of Dynex, the chambers judge held that by the terms of the clauses in the debenture and loan agreements, the Bank subordinated its interest to the previously granted interests of the ORRs. He reasoned that commercial reality of the oil and gas industry required that such effect be given to the documents.

24 In his reasons dated April 4, 1997 [reported at 46 C.B.R. (3d) 36], the chambers judge held that the Bank's subordination to the ORRs survives the **bankruptcy** of Dynex and that the ORRs are entitled to recover any of their losses in **bankruptcy** (that are not recovered from the Trustee) from the Bank.

25 He held that the interests of the ORRs constituted a chose in action, basically, an unsecured claim which could only be a secured interest in personalty if the ORRs had registered pursuant to the PPSA. That did not occur in this case. In **bankruptcy**, therefore, without the subordination agreement, the ORRs, as unsecured creditors, would have no priority over the Bank.

26 The chambers judge went on to hold that the subordination of the Bank to the ORRs exists and continues despite the **bankruptcy** because the subordination agreement did not expressly, or by implication, terminate upon **bankruptcy**.

27 However, Dynex's assets sold by the Trustee to Channel Lake were unencumbered by the interests of the ORRs as they were mere unsecured claims and therefore, Channel Lake Petroleum Ltd. acquired the Dynex properties free of the ORRs.

Analysis

Issue 1. Can net profits and overriding royalty interests, as a matter of law, constitute interests in land?

28 We are of the view that overriding **royalties** can be interests in land. There are practical reasons why ORRs should be treated as interests in land and where an agreement expresses the appropriate intentions, parties can grant or reserve interests in land.

General Observations

29 By way of general observation, we adopt those set out by Hunt J. (as she then was) in *Scurry-Rainbow Oil Ltd. v. Galloway Estate*, [1993] 4 W.W.R. 454 (Alta. Q.B.); appeal dismissed(1994), [1995] 1 W.W.R. 316 (Alta. C.A.); leave to appeal denied,(1995), 26 Alta. L.R. (3d) 1 (note) (S.C.C.), at pp. 464-5. Her first observation was a caution regarding reliance on American authorities:

> First, since the development of the oil and gas industry in Alberta and other parts of western Canada, Canadian courts have been called upon to make many decisions relating to the industry's activities. Due to the early dearth of jurisprudence and the fact that many industry practices in Canada were modelled upon those in the United States, Canadian courts have at times relied upon American decisions. Although such decisions can be of assistance, in my view they must be used cautiously because of the fact that different American jurisdictions have adopted varied approaches to basic concepts of oil and gas law, approaches that at times are in distinct contrast to those of Canadian courts....

Her second observation was a caution regarding rigid reliance on English common law:

> Second, in trying to come to grips with some of the novel legal problems created by the industry's presence in our country, Canadian courts have often drawn upon English common law concepts, especially those of real property law. That this should be the case is hardly surprising, given our legal traditions. Moreover, these traditional concepts have often proven helpful in sorting out complex problems. On the other hand, too rigid a reliance on common law principles that have developed in vastly different circumstances can lead to results that are out of touch with the realities of the industry and that deviate from the sorts of solutions needed by the affected parties....

Her third observation was the need to interpret documents within their context:

> A third and related point is that judicial resolutions of industry-related problems have typically occurred long after the fact, for example, long after a contract was entered into. Thus, the courts may have interpreted the language of a document two or three decades after it was drafted. These judicial views are often argued to be binding in the interpretation of other agreements entered into long before the jurisprudence was in existence, and of course, long before the parties could possible have known how the courts might construe the language they have chosen.... While these authorities should not be disregarded simply because they were later in time and thus could not have been in the contemplation of the drafters of the Agreements before me, the discrepancy in time is a factor to be weighed in considering the persuasiveness of such authorities in the context of the issues raised here.

Royalties** and Overriding **Royalties

30 A lessor's a **royalty** is a share of the product or the proceeds reserved to the owner for permitting another to use the property and also a right to receive, either in kind or its equivalent in money, a stipulated fraction of the oil and gas produced and saved from the property covered by the lease, free of all costs of development and production: E. Kuntz, *A Treatise on the Law of Oil and Gas* (Cincinnati, Ohio: Anderson, 1991) Vol. 1, s. 15.1.

31 An overriding **royalty** or a gross overriding **royalty** is an unencumbered share or fractional interest in the gross production granted to a third party in exchange for performing duties (*e.g.* drilling). Commonly, it is reserved in an assignment, part assignment or sublease of an oil and gas lease, often carved out or reserved by lessees who have a working interest created by a lease: G.J. Davies, in "The Legal Characterization of Overriding **Royalties** in Canadian Oil and Gas Law" (1972) 10 Alta. L. Rev. 232 at p. 233.

Net Profit Agreements

32 A net profits interest includes, at least, the right to receive a portion of the proceeds from the sale of petroleum and natural gas. Whether it is an interest in land was determined by Martland J. in *St. Lawrence Petroleum v. Bailey Selburn Oil & Gas Ltd.*, [1963] S.C.R. 482 (S.C.C.), by ascertaining the intention of the parties pursuant to two farmout agreements. He looked at both the wording and the context of the agreements in issues. They assigned "such an undivided interest in the petroleum and natural gas and related hydrocarbons... as well" after production was obtained and sold. In the opinion of Martland J. opinion, the interest was only an equitable interest because the interest was held in trust for the purposes of the agreement and the beneficiaries would receive the money equivalent of their share of the proceeds of production. He could not find that the parties contemplated or agreed to convey an interest in the lands capable of

assignment or registration. He agreed with the trial judge at p. 490, "Had it been intended to convey such an interest it would have been a very simple thing to do in plain and unmistakable words."

33 Martland J. left open the possibility that a net profits agreement can convey an interest in land where the parties intended to convey such an interest. Here, unlike *St. Lawrence Petroleum v. Bailey Selburn Oil & Gas Ltd.*, the agreement stated that the interest was an interest in land. But in each particular case, the interest conveyed is to be found by interpreting the agreement as a whole and within its context. A net profits interest; in many cases, can function in much the same manner as a **royalty** or other non-working interests where the interest is a right to a share of production as opposed to a right to a certain amount of money out of a certain described portion of production. The analysis which follows discusses **royalties** and overriding **royalties**, but where the intention of the parties to the net profits agreement was to create an interest analogous to that of a **royalty** or overriding **royalty**, we are of the opinion that the result should be the same.

*The Function of **Royalties***

34 A partial list of the ways in which **royalties** are used was set out by W. H. Ellis, "Property Status of **Royalties** in Canadian Oil and Gas Law" (1984) 22 Alta. L. Rev. 1 at pp. 2-3. They include financing the costs of drilling and spreading the risks of exploration. For the buyer, it is a chance to invest in areas where he or she may not own enough interest to consider drilling. For the seller, it is a way to realize immediately on part of the investment against the chance the hole will be dry and keep part of the investment on the chance that an oil or gas well will be drilled. This results in further economic benefits by stabilizing the volatile industry and raising money for exploration. Additionally, overriding **royalties** are used to compensate employees whose efforts determine the success of a project.

35 Ellis described two further characteristics important to understanding the function of **royalties** in the oil and gas industry. Oil and gas ventures require huge amounts of capital but only a small fraction are successful. The oil and gas investor is betting that the many losses will be made up by the small fraction of successes. Therefore, the industry needs first, the incentive to induce such high risk investments by offering the hope of a share of production from successful ventures. Second, good investment decisions in the oil and gas industry depend on good geological information. Geological information is information about specific land.

36 **Royalties** fit these characteristic needs because they are investments in a particular piece of property, not in a particular operator or company. There are other means for investing in the owner or operator. The investment return on a **royalty** results from the success of the property regardless of who owns or is working the property. These unique functions and characteristics apply equally to overriding **royalties** as well as **royalties**. The fact that overriding **royalties** are not granted from the whole of the mineral interest but from the working interest does not change their role in oil and gas production.

*Assumptions that **Royalties** are Interest in Land*

37 American authorities, Williams and Meyers, *Oil and Gas Law* (New York: Matthew Bender, looseleaf) assert that **royalties** are interests in land and that almost all courts in the United States treat them as such. As noted also by this Court in *Scurry-Rainbow, supra* at pp. 321-2, while it would be erroneous to rely too heavily on U.S. decisions, the American cases are persuasive when not in conflict with authoritative Canadian decisions.

38 In oral argument, counsel for the appellants asserted that despite the uncertainty in the common law and the absence of any statutory authority, overriding **royalty** holders are treated as having an interest in land when they are pursued for the costs of abandoned wells. (The abandonment costs procedure was described in *Panamericana de Bienes y Servicios S.A. v. Northern Badger Oil & Gas Ltd.* (1989), 75 Alta. L.R. (2d) 185 (Alta. Q.B.); (1991), 81 D.L.R. (4th) 280 (Alta. C.A.); leave to appeal refused (1992), 86 D.L.R. (4th) 567n (S.C.C.).)

39 Edward Evans, Forbes Newman and Keith Smith, in an article titled, "Overriding **Royalties** and Subleases as Interests in Land" *Papers Presented at the Mid-Winter Meeting of the Alberta Branch, Canadian Bar Association* (Calgary,

1988) pp. 406-457, analysed the overriding **royalty** provisions in the proposed model farm-out agreement prepared by a joint committee of the Canadian Bar Association Natural Resources Section and the Canadian Association of Petroleum Landmen. The authors, after reviewing case law, concluded at p. 424 that "an overriding **royalty**, properly drafted, can be an interest in land." They also made it clear that the oil and gas industry has traditionally assumed that overriding **royalties** were interests in land. As was done for some of the overriding **royalties** in this case, they have been registered as caveats with land titles offices on the assumption that they were interests in land.

40 Indeed, many transactions over many years have been predicated on this assumption. This is not a fact which should be taken lightly. This conclusion echoes the remarks of Ellis, in "Property Status of **Royalties** in Canadian Oil and Gas Law," *supra* at p. 10:

> **Royalties**, as used in the oil and gas industry, make sense only if they are property interests in unproduced minerals. Owners of **mineral rights** should be able to create them as such if they make clear their intent to do so.

41 Davies, *supra* at pp. 235-6, stated that the usual overriding **royalty** interest is limited to endure as long as the lease upon which it is raised and that in turn, is usually for a fixed term and thereafter for the producing life of the land. The overriding **royalty** is treated as analogous to a determinable fee interest, assuming that the overriding **royalty** is an interest in land.

42 Academic and professional literature, such as that cited above, support the view that overriding **royalties** should be classified as an interest in land primarily on the basis of expediency.

43 Eugene Kuntz, in a discussion paper entitled "Classifying Non-Operating Interests in Oil and Gas," (Calgary: Canadian Institute of Resources Law, 1988), argued that the law should provide a framework within which unnecessary risks for those who invest or participate in oil and gas operations are removed. The oil and gas industry has created new devices to meet the high risks of the enterprise. Included among the new devices are non-operating interests which are used to make the sharing of the benefits of mineral ownership definite and certain, minimize taxes, make clear delegation of operating rights and make proper allocation of the risks and rewards of an operation without invoking many objectionable features associated with creating a conventional business association. Non-operating interests include **royalty** interests, overriding **royalty** interests, production payments, net profit interests and carried interests.

44 He pointed out that it is of great importance to the party acquiring a non-operating interest that such an interest be classified as a property interest and not a mere contractual right in order to guard against the consequences of possible financial difficulties of the granting party and to protect the interests against the rights of third persons generally.

45 There are other practical arguments that can be marshalled to support overriding **royalties** as interests in land. First, certainty and stability are desirable qualities and the industry expects or assumes that overriding **royalties** can be interests in land. It should be noted, however, that for some time this assumption has been known to be somewhat tenuous — the body of literature on **royalties** as interests in land attests to this fact. Second, one consequence of the ruling below, that overriding **royalties** are not interests in land, is that some oil and gas companies with leases encumbered by overriding **royalties** may be worth more to a bank holding those leases as security if the company is petitioned into **bankruptcy** and the leases sold free of the ORRs, than if allowed to continue operating and paying the ORRs. This could create problems if it leads to otherwise unnecessary **bankruptcies**. Third, as Ellis argued, *supra*, at p. 4, **royalties** and overriding **royalties** as real property interests protect owners and purchasers against double conveyancing, innocent or otherwise.

*Lessor **Royalties** as Interests in Land*

46 Given the proper construction, lessor's **royalties** can constitute an interest in land.

47 *Scurry-Rainbow, supra* is the most recent important case concerning lessor's **royalties**. It dealt with **royalty** owners, who banded together and assigned their **royalties** to a trust in order to pool income and guarantee returns. *Scurry-Rainbow* makes several important points about the nature of lessor's **royalties**. Hunt J. found that the lessor's **royalty**

can be an interest in land in the form of a "species of rent" or akin to rent or a *profit à prendre*. Alternatively, even if a **royalty** was not an interest in land, a lessor could retain the capacity to transfer an interest in land in the future based upon reversionary rights under the lease.

48 In *Scurry-Rainbow*, Hunt J. held that a lessor's **royalty** could constitute an interest in land and further, that the lessor's interest could be assigned to a third party and retain its character as an interest in land.

49 The appeal to this Court was dismissed noting that the status of a **royalty** interest need not be decided. Nevertheless, this Court went on to consider American authorities which have held that a **royalty** reserved to a lessor is an interest in land and noted that concept is consistent with the decision of the Supreme Court of Canada in *Berkheiser v. Berkheiser*, [1957] S.C.R. 387 (S.C.C.) and an earlier decision of this Court, *Re Publix Oil & Gas Ltd.*, [1936] 3 W.W.R. 634 (Alta. C.A.).

*No Practical Difference Between **Royalties** and Overriding **Royalties***

50 For all intents and purposes, an overriding **royalty** is the same as a **royalty**; both are an unencumbered share of production. To distinguish between these two forms of **royalty** is to place form before substance. **Royalties**, whatever their origin, should be subject to the same set of rules.

51 In this case, however, the chambers judge held that he was bound by authorities which state that an interest in land cannot be passed to a third party from a lessee of an oil and gas lease. The argument can be summarized as follows: A lessee only possesses a *profit à prendre*. A *profit à prendre* is an incorporeal hereditament. An interest in land can only be created from the corporeal estate.

52 The principles inherent in the above argument need not be applied to prevent an overriding **royalty** from being an interest in land for a number of reasons. First, **royalties** and ORRs need not be classified into a traditional common law property category unsuited to the realities of the oil and gas industry and need not be subject to the arcane strictures of traditional categories. Second, some authorities suggest it is possible to have an incorporeal interest (an overriding **royalty**) created from an incorporeal interest. Third, even if it is not possible, the rule need not be blindly adhered to because, as stated by Mr. Justice Holmes in "The Path of the Law" (1897) 10 Harv. L. Rev. 457 at p. 469, it is "revolting to have no better reason for a rule of law than that so it was laid down in the time of Henry IV," and "still more revolting if the grounds upon which it was laid down have vanished long since, and the rule persists from blind imitation of the past."

***Royalty** Interests As Akin to Rent or Profit*

53 *Berkheiser*, *supra* at p. 391 held that an oil and gas lease is not a lease in the normal sense of the term; rather, it is a *profit à prendre*: A *profit à prendre* is essentially a right to come onto an estate to capture or take a resource. *Berkheiser* further held at pp. 391-4 that if a lease was a *profit à prendre*, then as a mere right over land rather than being an estate proper, it was only an incorporeal interest in land.

54 However, Hunt J. in *Scurry-Rainbow, supra*, suggested *Berkheiser* also could be interpreted to say that **royalties** are a species of profit. Further, she rejected the argument that a **royalty** must fall into some pre-existing category and not be considered as analogous to an existing interest such as rent. She rejected the argument for three reasons.

55 First, other courts which recognized a **royalty** as an interest in land did not specify the nature of the interest. She concluded that the notion that categories of interest in land were closed did not figure in at least two of those decisions, *Canco Oil & Gas Ltd. v. Saskatchewan, infra* and *Publix Oil & Gas Ltd.*, *supra*.

56 Second, the notion of closed categories of interests in land was an overly restrictive view of the law. Hunt J. held that courts must be prepared to respond to the challenges presented in categorizing and classifying legal relationships and devices created by human ingenuity. She noted, as an example, that the category of easements is not closed.

57 Third, the unique physical properties of oil and gas have always required that the courts be creative and at times to analogize. This was the situation in the case before her and also was the view of Laskin J. (as he then was) in *Saskatchewan Minerals v. Keyes* (1971), [1972] S.C.R. 703 (S.C.C.) at p. 728 when he found a lessee's **royalty** to be analogous to a rent-charge. Hunt J. found additional support that the oil and gas industry posed challenges for the law in the observations of the Supreme Court of California in *Callahan v. Martin*, 43 P.2d 788 (U.S. Cal.1935) at p. 791:

> The difficulty ... is due in part to the fact that the oil industry is of very recent development, while in the country ... our classification of property as realty or personalty is based on common-law definitions which crystallized in a time when oil interests were not the subject of judicial cognizance.

58 Other courts have regarded **royalties** as analogous to rent. In *Dawson v. Bell*, [1945] O.R. 825 (**Ont**. C.A.), for example, the **Ontario** Court of Appeal held that **royalty** payments under a lease of a tract of land were in essence rent. The majority held *per* McRuer J.A. at p. 835 that the right granted under the lease was "a *profit à prendre* in gross, an incorporeal hereditament, which is an estate in the whole land and which will continue to exist, unless otherwise terminated, as long as oil or gas is produced under the provisions of the lease." Relying on the English decision, *R. v. Westbrook* (1847), 10 Q.B. 178 (Eng. Q.B.) and finding nothing in the reasoning of the American courts that took a contrary view, the majority concluded at p. 842 that "a **royalty** is compensation for the right to occupy land, and that in its essence it is rent."

The Corporeal/Incorporeal Problem

59 When it comes to overriding **royalties**, the objection has been raised that there can be "no rent on a rent". As stated by R.E. Megarry and H.W.R. Wade, *The Law of Real Property*, 4th ed. (London: Stevens & Sons, 1975) at p. 794:

> At common law a rentcharge could be charge only upon a corporeal hereditament. There could be no rentcharge charged upon another rentcharge or other incorporeal hereditament, since obviously there could then be no right of distress.

60 This longstanding rule of real property law that rent cannot issue out of an incorporeal hereditament was observed by Laskin J., in *Saskatchewan Minerals v. Keyes, supra* at pp. 721-22:

> At common law, whether a **royalty** could be classified as rent, and hence enjoy in its unaccrued state the character of an interest in land, depended on whether it issued out of a "corporeal" interest, as, for example, out of an estate in fee of minerals in place, or whether it was incident to a reversion upon a true lease which also gave a right to extract minerals. In the former case it would be in effect a rent-charge; in the latter, a rent service. Rent at common law could not issue out of an "incorporeal" interest, as for example, a *profit à prendre* in gross; and whatever it might be called, it would not be an interest in land.

Hunt J. reiterated Laskin J.'s point in *Scurry-Rainbow, supra* at p. 472.

61 Laskin J. also noted at p. 722 that "it is only the unconfronted force of a long history that makes it necessary in this case to examine certain institutions of property in the common law provinces through an antiquated system of classification and an antiquated terminology."

62 The reason for the requirement that rent issue out of a corporeal interest is, as set out in Megarry and Wade quoted above, that a rentcharge upon another rentcharge, or other incorporeal hereditament, results in the absence of a right to distrain. The remedy of distress can only exist where the underlying interest is a corporeal hereditament.

63 **Royalty** owners do not have the remedy of distress. And therefore, the argument goes, a **royalty** cannot be treated as rent nor can an overriding **royalty**.

64 The right to distrain need not be available in order for a **royalty** to be an interest analogous to rent. Indeed, as Ellis, *supra*, stated at p. 10, "The idea that **royalty** owners could summarily seize drilling and producing equipment worth millions of dollars, especially in fields where drainage might be going on, is unthinkable."

65 Additionally, it may be that rent can issue out of an incorporeal hereditament. No Canadian case has held that overriding **royalties** cannot be created as a property interest on the basis that a rent cannot be created out of rent.

66 Rather, the contrary conclusion can be implied in *Saskatchewan Minerals v. Keyes*. Laskin J. appeared to find that rent could issue out of an incorporeal hereditament. Though he did not explicitly say so, he may have had in mind a different sort of rent. Some authors have argued that **royalties** are analogous to an ancient form of rent: rent seck. See, A. W. Walker, "The Nature of the Property Interests Created by an Oil and Gas Lease in Texas" (1928) 7 Texas L. Rev. 1; Davies, *supra*; and Ellis, *supra*. A rent seck is a rent unsupported by the remedy of distress: Megarry and Wade, *supra* at p. 793. In practice, rents seck have all but disappeared because of statutory prescriptions. Nevertheless, the existence of rents seck suggests that an interest in land analogous to rent may exist without being tied to the remedy of distress. While Justice Laskin's decision is inconclusive on the issue of whether an overriding **royalty** can be an interest in land, he suggested that the ancient rule that a rent could not be created out of an incorporeal interest need not be an impediment to the application of the rent analogy to overriding **royalties** in Canada.

67 The longstanding dichotomy between corporeal and incorporeal rights, described by A. H. Oosterhoff and W. B. Rayner, *Anger and Honsberger Law of Real Property* (Toronto: Canada Law Book, 1985) at pp. 10-11 as "meaningless and confusing," and which underlies the old rule that rent cannot issue out of an incorporeal hereditament, should not be an obstacle to a reasonable result in the case of overriding **royalties**.

The Parties' Intentions

68 Whether a particular interest is an interest is land requires determination of the parties' intentions. This was the approach of Laskin J. in *Saskatchewan Minerals v. Keyes*, when he proceeded to consider the **royalty** before him and concluded that the formulation of the **royalty** accords with language that has been held sufficient for the creation of an interest in land. He rejected an overly literal approach to interpreting whether a **royalty** agreement indicated an interest in land or only a contractual right. He stated at p. 725:

> The words in which [a **royalty**] is couched may show that only a contractual right to money or other benefit is prescribed. However, if the analogy is to rent, then the fact that the **royalty** is fixed and calculable as a money payment based on production or as a share of production, or of production and sale, cannot alone be enough to establish it as merely a contractual interest.

69 Similarly, as observed earlier, in *Scurry-Rainbow*, Hunt J. concluded at p. 474 "that the lessor's **royalty** under the Rio Bravo lease *can* be considered an interest in land... Whether that was the intention of the parties ... remains to be determined." [Emphasis in original] She held at p. 488 that in the context of the agreements, "a literal approach should not be followed if it would bring about an unrealistic result not contemplated in the commercial context of the times." In contemplating the essential nature of the oil and gas lease transaction, she held that regard should be given to what the parties are actually doing.

70 *Canco Oil & Gas Ltd. v. Saskatchewan* (1991), 89 Sask. R. 37 (Sask. Q.B.) (Q.B.) also supports the proposition that **royalties** generally can be interests in land if the parties intend to create an interest in land. In that case, the parties' intentions were determined from the words of the grant.

71 The registered owner of the mines and mineral interests assigned a gross **royalty** on substances produced, saved and sold from certain lands. The **royalty** agreement in *Canco* contained three important clauses. Clause 1 provided that the grantor "hereby grant, assign, transfer and convey to the grantee a gross **royalty** of 3% of all petroleum, natural gas and related hydrocarbons (except coal) . . . produced, saved and sold from those certain parcels of land." Clause 3 explicitly

stated that the parties intended to create an interest in land. Clause 7 reserved operating rights to the grantor. (This can be read to imply that such rights may have normally passed under the **royalty** agreement.)

72 N. Bankes and Bennett Jones, *Canadian Oil and Gas*, 2d ed. (Toronto: Butterworths, looseleaf) at Dig-877, suggest that the following factors in *Canco* led to the characterization of the **royalty** as an interest in land:

> (1) the **royalty** was carved out of what was clearly an interest in land (fee simple interest);
>
> (2) clause 3 and the language of grant in clause 1 indicated that it was the intention of the parties that the **royalty** be an interest in land;
>
> (3) if it was a necessary condition of an interest in land that it also grant operating rights, clause 7 indicated that these rights might have been an incident of the grant and had been relinquished.

73 The approach of both Matheson J. in *Canco* and Hunt J. in *Scurry-Rainbow* was to examine the parties' intentions from the agreement as a whole, along with the surrounding circumstances, as opposed to searching for some magic words. Matheson J. stated at p. 47:

> ... the principal questions are whether Farmers Mutual was capable of granting an interest in the lands and whether it intended to do so and whether it accomplished that intention. As owner of a designated interest in mines and minerals in fee simple, Farmers Mutual clearly possessed an interest in the lands, and the wording of the **Royalty** Agreement permits of no other conclusion but that Farmers Mutual intended that the grant of the 3% gross **royalty** should constitute an interest in the lands. The fact that Farmers Mutual did not utilize all of the wording, or type of wording considered by some persons as perhaps essential, can surely not detract from an otherwise clearly manifested intention to create an interest in the lands.

And according to Hunt J. in *Scurry-Rainbow, supra*, at p. 474:

> There is in my view an unreality about placing too heavy an emphasis upon fine distinctions as the selection of words such as "in" rather than "on". Notwithstanding the significance that the courts have sometimes attached to these word choices, I doubt that parties who signed leases... should be taken to have intended to create an interest in land as opposed to a contractual right, as a result of such minuscule differences in language.... Rather, it is more appropriate to consider the substance of the transaction (namely, what were the parties actually trying to achieve?) and to regard the words they have used from that perspective.

United States Authorities

74 No U.S. authorities on overriding **royalties** were provided by the parties. American case law, however, can be useful when considering issues not previously decided in Canada, particularly, in the context of oil and gas. However, as noted by Fruman J. (as she then was) in *Anderson v. Amoco Canada Oil & Gas* [(1998), 63 Alta. L.R. (3d) 1 (Alta. Q.B.)], at p. 41:

> American case law must be read with care. Unlike Canada, many U.S. states have adopted theories of ownership. Cases decided in one state may not apply in others because they differ in their classification of the interests landowners hold in oil and gas.... Because of the differing theories of ownership among various states, it is often inappropriate to extrapolate decisions from a specific state as representing American oil and gas law generally.

75 This Court stated in *Scurry-Rainbow, supra* at pp. 321-2, while it would be erroneous to rely too heavily on U.S. decisions, the American cases are persuasive when not in conflict with authoritative Canadian decisions. The decision of the Supreme Court of Canada in *Berkheiser*, *supra*, was entirely consistent with the American authorities in recognizing that in a mineral lease of the nature under consideration, the owner retained an interest in land and that the interest in the **royalties** to be received under the lease formed part of that interest and was also an interest in land.

76 An overwhelming majority of American jurisdictions hold that an overriding **royalty** can be an interest in land.

77 Williams and Meyers, *supra*, leading authorities on U.S. oil and gas law, conclude at para. 554 that overriding **royalties** are usually held to be interests in land or real property because they are conveyances or reservations of a part of the lessee's interest which (in most United States jurisdictions and in Canada) is itself real property.

78 They also note at para. 418.1 that the classification of overriding **royalties** "as realty or personalty in any particular jurisdiction corresponds to that jurisdiction's classification of an ordinary **royalty**". The status of **royalties** varies from jurisdiction to jurisdiction, but the dominant trend is that found in Texas: when a **royalty** or leasehold interest can last for the duration of the freehold estate, it is to be treated as real property (at para. 214). The learned authors do not offer any principled justification for grouping lessors' **royalties** and overriding **royalties** together — practical concerns seem to dictate the approach.

79 Kuntz, "Classifying Non-Operating Oil and Gas Interests" *supra* at p. 14 summarizes that "where the lease is treated as an interest in land, as it is in an overwhelming majority of the states with a decision on the subject, the overriding **royalty** is also treated as an interest in land."

80 According to Davies, *supra* at pp. 241ff, there are three ways in which American courts have found that lessor's **royalties** and overriding **royalties** are interests in land:

1. The **royalty** is a reservation or exception of title to a fraction of the oil and gas in place.

2. The **royalty** is a *profit à prendre* or as a co-tenancy in a *profit à prendre*.

3. The **royalty** is rent or an interest analogous to rent.

81 Finally, Williams and Meyers, *supra*, comment at para. 215:

> We are of the opinion that in states in which the [realty/personalty] classification question has not been decided as to a particular interest, classification as realty [i.e. an interest in land] rather than as personalty is preferable if the particular interest has the duration of a freehold.

Conclusion

82 For all the above reasons, we conclude that parties may create overriding **royalties** that are interests in land if they manifest their intention to do so.

83 In order to determine the parties' intentions, findings of fact must be made.

84 As gleaned from the authorities, various indicia could be used to identify whether or not an interest in land was intended. The set of indicia, which is not exhaustive but may be relevant, is:

1. The underlying interest is an interest in land (corporeal or incorporeal);

2. The intentions of the parties, as evidenced by the language of the grant and any admissible evidence of the surrounding circumstances or behaviour, indicate that it was understood that an interest in land was created/conveyed;

3. The interest is capable of lasting for the duration of the underlying estate.

85 Other possible indicia were set out by Evans, Newman and Smith, *supra*, at pp. 447-456 in their proposed model form overriding **royalty**. They include wording in the overriding **royalty** clause which create:

1. A reservation of interest in the petroleum substances by the farmor in the working interest to be earned by the farmee.

2. The farmee as agent of the farmor for the farmor's share of petroleum production.

3. Remedies against the interest of the farmee through a lien.

86 This matter initially came before the chambers judge on applications under R. 220 and 221, for a preliminary determination before trial. Having found that the overriding **royalties** may be interests in land, depending upon the agreements between the parties, the final determination of this matter requires findings of fact. It cannot be determined under R. 220 or 221.

87 The chambers judge stated, and both Enchant and the Bank agreed, in such a case, this matter must go back for trial. During oral argument, the parties also agreed that should this matter go back for trial on the issue of whether there was an interest in land, then any equitable remedies that Enchant and Willness may have against the Bank may be raised and Willness and Enchant should be allowed to adduce evidence and argue any and all equitable remedies which they might have against the Bank.

88 Since the first issue must be determined by a trial, which may render the second and third issues wholly or partially moot, it is preferable that those two issues be determined in the context of the trial evidence, and in conjunction with any other issues, equitable or otherwise which might impact on the result relating to those issues.

89 For that reason, the second and third issues are directed to be tried together with the first. In the result, the appeal is allowed on the first issue but the second and third issues are to be determined at trial in accordance with the preceding paragraph. The success on this appeal has been divided. Costs, therefore, are not awarded to either party.

Appeal allowed.

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2010 NBQB 91
New Brunswick Court of Queen's Bench

Blue Note Caribou Mines Inc., Re

2010 CarswellNB 114, 2010 NBQB 91, 186 A.C.W.S. (3d) 594, 356 N.B.R. (2d) 236, 919 A.P.R. 236, 91 R.P.R. (4th) 86

In the Matter of the Companies' Creditors Arrangement Act, R.S.C. 1985, c. C-36

In the Matter of the Application of Blue Note Caribou Mines Inc., a body corporate

In the Matter of the Application of PricewaterhouseCoopers Inc., Trustee in **Bankruptcy** of Blue Note Caribou Mines Inc.

In the Matter of an Application by Breakwater Resources Ltd. and Canzinco Ltd. for Various Orders Relating to the Stay of Proceedings Against Blue Note Caribou Mines Inc.

In the Matter of the Application by J.S. Redparth Limited (Court File No. N/C/68/08) and Longyear Canada, ULC and Boart Longyear Alberta Limited, doing business under the name and style of Boart Longyear Canada (Court File No. N/C/68/08), Lien Claimants, for an Order lifting the Stay Order and continuing the said Lien Claimants' Action

J.A. Réginald Léger J.

Heard: January 12-16, 2010
Judgment: March 11, 2010
Docket: B/M/06/09

Counsel: Stephen J. Hutchison, Jeffrey Parker, Alana Waberski, for CanZinco Ltd., Breakwater Resources Ltd.
Steven L. Graff, Aaron T. Collins, for Senior Secured Noteholders
John B.D. Logan, Natalie LeBlanc, for Office of the Attorney General for the Province of New Brunswick
Howard Gorman, for Maple Minerals Corporation
Gerald F. Smith, for J.S. Redpath Ltd., Longyear Canada, ULC, Boart Longyear Alberta Ltd.
George L. Cooper, Joshua J.B. McElman, Rebecca Atkinson, for PricewaterhouseCoopers
Matthew Gottlieb, Jeffrey Lem, Thomas O'Neil, Melissa Young, for Fern Trust
Robert C. Smith, for PricewaterhouseCoopers as Court appointed monitor

Subject: Insolvency; Estates and Trusts; Property; Natural Resources; Contracts

Headnote

Bankruptcy and insolvency --- Administration of estate — Sale of assets — Procedure on opposition to sale

BNC Inc. operated underground mining and mineral processing property and related assets — On July 14, 2009, BNC made assignment into **bankruptcy** — PWC was also appointed as trustee under **Bankruptcy** and Insolvency Act — Just hours before public auction was to take place and after several hours of negotiations, PWC in its capacity as monitor and as trustee of BNC, entered into agreement with **Ontario** numbered company, later to be MM Corp., for purchase and sale of assets of BNC, including real property — Sale agreement provided that PWC would apply to court and seek order that purchaser obtain title in assets free and clear from any and all interest or encumbrances — Subsequently, PWC sought order enabling MM Corp. as purchaser, to acquire real property of BNC, including mining leases and **mineral rights** free and clear from any interest, thereby extinguishing any liens against or interest

in property — DS Limited as trustee for Fern Trust asserted that it had 10 percent net profit interest ("NPI") in mine — BR Ltd. also opposed motion, claiming property interest in mine, an interest which it argued was acquired by virtue of previous agreement entered into with BN Inc., parent company of BNC — Order accordingly — Net Profit Interest Agreement was not terminated and paragraph (f) in NPI Agreement was not triggered by BNC's insolvency — BWR had 20 percent proprietary right in real property of mine — Record was insufficient to allow BWR's request that it be allowed to exercise right of first refusal pursuant to terms of Joint Venture Agreement — Also, note indenture held by CS was subject to proprietary interest of BWR — Finally, request by BWR and some of lien claimants that stay of proceedings order be lifted was denied.

Table of Authorities

Cases considered by *J.A. Réginald Léger J.*:

Blue Note Mining Inc. v. Merlin Group Securities Ltd. (2008), 337 N.B.R. (2d) 116, 864 A.P.R. 116, 2008 CarswellNB 469, 2008 NBQB 310 (N.B. Q.B.) — referred to

Blue Note Mining Inc. v. Merlin Group Securities Ltd. (2009), 2009 NBCA 17, 2009 CarswellNB 107, 2009 CarswellNB 108, (sub nom. *Blue Note Mining Inc. v. Diorite Securities Ltd.*) 342 N.B.R. (2d) 151, (sub nom. *Blue Note Mining Inc. v. Diorite Securities Ltd.*) 878 A.P.R. 151 (N.B. C.A.) — referred to

Irving Pulp & Paper Ltd. v. C.E.P., Local 30 (2002), 249 N.B.R. (2d) 28, 648 A.P.R. 28, 2002 CarswellNB 107, 2002 NBCA 30 (N.B. C.A.) — referred to

Manulife Bank of Canada v. Conlin (1996), 1996 CarswellOnt 3941, 1996 CarswellOnt 3942, 6 R.P.R. (3d) 1, 94 O.A.C. 161, 203 N.R. 81, [1996] 3 S.C.R. 415, 139 D.L.R. (4th) 426, 30 O.R. (3d) 577 (note), 30 B.L.R. (2d) 1 (S.C.C.) — considered

Orbus Pharma Inc. v. Kung Man Lee Properties Inc. (2008), 2008 ABQB 754, 2008 CarswellAlta 2019, 77 R.P.R. (4th) 135, 463 A.R. 351, 3 Alta. L.R. (5th) 157, [2009] 5 W.W.R. 97 (Alta. Q.B.) — considered

Pharmacie Acadienne de Beresford Ltée v. Beresford Shopping Centre Ltd./Ltée (2008), 290 D.L.R. (4th) 294, 841 A.P.R. 205, 328 N.B.R. (2d) 205, 74 C.C.L.I. (4th) 196, 2008 NBCA 12, (sub nom. *Robichaud, Williamson, Theriault, and Johnstone v. Pharmacie Acadienne de Beresford Ltée*) [2008] I.L.R. I-4680, 2008 CarswellNB 61, 2008 CarswellNB 62 (N.B. C.A.) — followed

Statutes considered:

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Bankruptcy *Act*, R.S.C. 1970, c. B-3
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Generally — referred to

s. 81(1) — referred to

Companies' Creditors Arrangement Act, R.S.C. 1985, c. C-36

Generally — referred to

s. 11 — referred to

Mechanics' Lien Act, R.S.N.B. 1973, c. M-6
Generally — referred to

Mining Act, S.N.B. 1985, c. M-14.1
Generally — referred to

Property Act, R.S.N.B. 1973, c. P-19
Generally — referred to

MOTION by trustee seeking order enabling purchaser to acquire real property of BNC, including mining leases and **mineral rights** free and clear from any interest, thereby extinguishing any liens against or interest in property.

***J.A. Réginald Léger J.*:**

1 Blue Note Caribou Mines Inc. (BNC) operated an underground mining and mineral processing property and related assets located approximately 50 km west of Bathurst, New Brunswick, as well as an open-pit mining property located in the County of Restigouche, New Brunswick. In February 2009, BNC sought protection pursuant to the *Companies' Creditors Arrangement Act* (CCAA). On February 20th, 2009, an initial order was granted and pursuant to Section 11 of the CCAA, any and all proceedings commenced, taken or continued against or in respect to BNC were stayed until March 22nd, 2009. PricewaterhouseCoopers Inc. (PWC) was appointed as monitor of the business and affairs of BNC. Further orders have since extended the Stay of Proceedings until the 21st day of May 2010. Beginning with the May 20th, 2009 order, each of the extension orders contained a clause which stated:

> Nothing in this order shall give the Monitor, the Applicant or any liquidator the right to sell any real property including mining rights, leases and licences in connection with the Caribou Mine without further order of the Court (on reasonable notice to the Fern Trust, CanZinco Ltd. and Breakwater Resources Ltd.) or without the written consent of the Fern Trust, CanZinco Ltd. and Breakwater Resources Ltd.

2 On July 14th, 2009, BNC concurrently with the CCAA proceedings, made an assignment into **bankruptcy**. PWC was also appointed as trustee under the ***Bankruptcy*** *and Insolvency Act* (BIA).

3 By order dated July 27, 2009, PWC was authorized to carry out the plan of liquidation as described in the Monitor's third report. Consequently, a public auction of the assets of BNC was scheduled for September 30, 2009. Only the tangible personal property of BNC was to be sold at the public auction. In an affidavit sworn September 28, 2009, Robert C. Smith of PWC confirmed that the intention of PWC was not to sell the assets of BNC but to liquidate the assets on a piecemeal basis. More particularly, Mr. Smith stated:

> As will more fully appear by reference to the three Monitor's reports before the Court, substantial efforts were undertaken in the months since the granting of the initial order of February 20, 2009, with a view to selling all of BNC's assets as a going concern. Those efforts did not result in a sale.
>
> Accordingly, as an alternative to selling the assets *en bloc*, it was determined that efforts would be made to liquidate the assets on a piecemeal basis.

4 Just hours before the public auction was to take place and after several hours of negotiations, PWC in its capacity as monitor and as trustee of BNC, entered into an agreement with an **Ontario** numbered company, later to be Maple

Minerals Corporation, for the purchase and sale of the assets of BNC, including the real property. The sale agreement provided that PWC would apply to the court and seek an order that the purchaser obtain title in the assets free and clear from any and all interest or encumbrances. The agreement provided in part as follows:

> The Monitor does not currently have the authority of the Court to sell the lands, however the Monitor agrees it will sell the lands to no other party until this matter is dispensed with and a final Order issued by the Court, and the Monitor (and the Purchaser if appropriate) shall apply to the Court and make good faith efforts to obtain for the purchaser good and marketable title to, and a 100% interest in the Assets free and clear of all liens, mortgages, charges, security interests, pledges, encumbrances, restrictions, **royalties**, claims and demands (including, without limitation, any claims and demands by or on behalf of any and all current or former employees) whatsoever (collectively, "Liens") including, without limitation, any Liens by or in favour of CanZinco Ltd., Breakwater Resources Ltd., The Fern Trust, any creditors, secured or otherwise, of Blue Note and any environmental or reclamation obligations respecting the Properties or any current or prior operations thereon except for the current agreement pertaining to the Deposit. The Monitor shall file the initial application and thereafter all costs of such application(s) and related activities shall be paid by The Purchaser.

5 The Sale Agreement contemplates the sale of assets in two stages: Stage I of the transaction being for the personal assets of BNC in the amount of three (3) million dollars. Stage II of the Sale Agreement provides for the conveyance of the lands, mining leases and mineral claims for another 1.25 million dollars. As a condition precedent to the completion of the second stage of the Sale Agreement, PWC is required to seek court approval to extinguish any liens on the property.

6 The first stage of the transaction was completed on October 7th, 2009 with the payment by Maple Minerals of 3 million dollars. The second stage of the transaction is the principle reason for the motion filed by PWC on November 19, 2009 whereby PWC is seeking the approval of the transfer of the lands, mining leases and mineral claims to Maple Minerals Corporation free and clear from all interest, liens and encumbrances, such as they are defined in the Sale Agreement. More particularly, PWC is seeking the following order:

> ii) approving the transaction (the "Transaction") contemplated by an agreement dated as of September 30, 2009, as amended by extension agreement dated October 7, 2009 (the "Sale Agreement") between the Applicant and Maple Minerals Corporation (formerly known as 647078 N.B. Inc.) (the "Purchaser"), a (redacted) copy of which is attached to the Applicant's affidavit in support of the within motion...
>
> iii) authorizing and approving the execution by the Applicant of the Sale Agreement and the Applicant executing such other documents of the taking of such additional actions as may be necessary or desirable to complete the Transaction and to convey the assets more particularly set out in Exhibit "O" to the Report (the "Sale Assets") to the Purchaser;
>
> iv) declaring that upon the delivery of a certificate or certificates to the Purchaser substantially in the form attached as Schedule "A" to the Draft Order (the "Applicant's Certificate"), all right, title and interest in and to the Sale Assets shall vest absolutely in the Purchaser free and clear of and from any and all other interests, claims or encumbrances of any nature or kind including, without limitation, the interests, if any, of Fern Trust, CanZinco Ltd. and Breakwater Resources Ltd.; and
>
> v) to the extent necessary, declaring that for the purposes of determining the nature and priority of claims, the net proceeds from the sale of the Sale Assets (the "Proceeds") shall stand in the place and stead of the Sale Assets, and that from and after the delivery of the Applicant's Certificate all claims and encumbrances shall attach to the Proceeds with the same priority as they had with respect to the Sale Assets immediately prior to the sale;

7 In simple terms, PWC is seeking an order enabling Maple Minerals Corporation as purchaser, to acquire the real property of BNC, including the mining leases and **mineral rights** free and clear from any interest, thereby extinguishing

any liens against or interest in the property. On December 31, 2009, PWC filed an amended Notice of Motion seeking substantially the same relief with some amendments to the grounds on which it relied upon.

8 The motion is strongly opposed. Diorite Securities Limited as trustee for the Fern Trust (the Fern Trust), asserts that it has a 10% net profit interest (NPI) in the Caribou Mine which runs with the mine. The Fern Trust claims that it owns a 10% property interest in the Caribou Mine, an interest it claims they have held since the early 1990's. The Fern Trust does not oppose the sale of the mine as such, but wishes to assert and protect what it calls its valuable property interest which it has owned for almost twenty years. The Fern Trust is simply requesting that the NPI in the Caribou Mine not be vested out or extinguished by this Court. If the Monitor's motion is granted, the NPI in the Caribou Mine would in effect, be extinguished.

9 Breakwater Resources Ltd. (BWR) also opposes the motion filed by PWC. BWR also claims a property interest in the Caribou Mine, an interest which it argues was acquired by virtue of a previous agreement entered into with Blue Note Mining Inc., the parent company of BNC. In fact, BWR filed a separate motion seeking an order declaring its property interest in the mine. I reproduce the relief sought by BWR in its motion filed on January 7th, 2010, which reads as follows:

> b) an order setting aside the Notice of Disallowance issued by PricewaterhouseCoopers Inc. ("PwC") on December 28, 2009, pursuant to which the Proof of Claim (for the Reclamation of Property) filed on behalf of Breakwater on December 23, 2009 was disallowed;
>
> c) an order declaring that, pursuant to Article 3 of the Unsecured Subordinated Convertible Debenture in issue in this matter (the "Debenture") and the Joint Venture Agreement in issue in this matter (the "Joint Venture Agreement"), Breakwater is entitled to a 20% ownership interest in the mineral properties and mine facilities comprising the Caribou and Restigouche Mines (the "Real Property") as described in Schedule 1.1(6) to the Asset Purchase Agreement in issue in this matter (the "Asset Purchase Agreement");
>
> d) an order declaring that, pursuant to Article 3 of the Joint Venture Agreement, Breakwater is entitled to a 20% undivided beneficial interest in all property used in connection with the Mines and including a 20% ownership interest in the Real Property;
>
> e) an order declaring that PricewaterhouseCoppers Inc. ("PwC") did not possess the authority to enter into an agreement dated as of September 30, 2009, as amended by an extension agreement dated October 7, 2009, (the "Sale Agreement") for the sale of the property of Blue Note Caribou Mines Inc. ("Blue Note Caribou") to Maple Minerals Corporation (formerly 647078 N.B. Inc., the "nominee" of 2190776 **Ontario** Inc.);
>
> f) an order declaring that Breakwater possesses and is entitled to exercise its rights of first refusal contained in Articles 14 and 15 of the Joint Venture Agreement (the "Rights of First Refusal") so as to acquire all of the property and interest of Blue Note Caribou which was offered for sale under the Sale Agreement on the same terms and conditions as contained therein;
>
> g) an order directing PwC, Blue Note Mining Inc. ("Blue Note") and/or Blue Note Caribou to execute and deliver, and/or request that Computershare Trust Company of Canada execute and deliver, such deeds or other instruments as may be necessary to release the 20% interest of Breakwater from the security interests of Computershare Trust Company of Canada and to cause such interest to be recorded in the name of Breakwater of its nominee;
>
> h) An order lifting or setting aside the stay imposed in the within matter by virtue of section 11 of the *Companies' Creditors Arrangement Act*, R.S.C. 1973, c. C-36, as amended (the "CCAA") for the purpose of enabling Breakwater to enforce its rights under the Debenture and the Joint Venture Agreement;

i) in the alternative, an order declaring that, if the claims of Breakwater to an interest in the Mines under the Debenture and/or Joint Venture Agreement are disallowed, then Breakwater is entitled to the Net Smelter Return **Royalty** which is a right which runs with the Mines and binds any successive operators thereof;

10 During the hearing, counsel for BWR indicated that paragraphs (e) and (g) were withdrawn. BWR's motion is opposed by PWC and not surprisingly, Maple Minerals Corporation.

11 During the course of the lengthy hearing on the motions, counsel for BWR also advised that BWR was not raising any issues with respect to Stage I of the Sale Agreement. BWR is only claiming an interest with respect to the second stage of the transaction between PWC and Maple Minerals Corporation. In other words, the motions before this court deal only with the interest in real property, with the sale of the personal assets of BNC not being challenged. Consequently, stage I of the Sale Agreement is now completed with Maple Minerals having title in the personal assets of BNC by virtue of the September 30 th , 2009 agreement which was completed on October 7 th , 2009.

12 At the end of the hearing, counsel for the Attorney-General for the Province of New Brunswick who, among others, was representing Provincial Holdings Ltd., advised that the Province supports the transaction. Basically, the provincial government simply wishes that the transaction proceeds as planned, so that the Caribou Mine can return to production. The Attorney General however, took no position on the issues raised by BWR and the Fern Trust. Counsel for the Provincial Holdings Ltd. was not in a position to advise the Court what Provincial Holdings would do in regards to the exercise of its security in the event it would be required to do so. Counsel acting for Provincial Holdings Ltd. simply advised that he had received no instructions on this issue.

13 It must also be noted that several liens have been filed pursuant to the *Mechanics Lien Act* of New Brunswick. The total amount claimed by the Lien Claimants is approximately twelve (12) million dollars. The liens are at various stages of proceedings and all have been stayed by virtue of the CCAA and the BIA proceedings. On the whole of the evidence, I am satisfied that Computershare Trust Company of Canada (Computershare) and Provincial Holdings Ltd. hold charges on the property that rank ahead of the Lien Claimants. However, I wish to point out that no written independent legal opinion was provided with respect to the various security interests in the instant case.

14 In order to correctly understand and determine the issues raised by the two motions before this court, it is necessary to relate the background behind the claims put forward on behalf of the Fern Trust and Breakwater Resources Ltd.

The Fern Trust

15 The claim by the Fern Trust to the NPI arises by virtue of an agreement dated August 9 th , 1990 (the NPI Agreement), by which East West Caribou Mining Limited (Caribou) granted to East West Minerals N.L. (East West) a 10% net profit interest in the Caribou Mine. The Fern Trust is now the owner of the NPI and has owned the NPI since 1991.

16 Howard Miller, a resident of the United Kingdom, filed a lengthy affidavit on behalf of the Fern Trust. Mr. Miller has been closely involved in the Caribou Mines over many years. In his detailed affidavit, Mr. Miller related the history of his involvement with the Caribou Mine including the many transactions that have led to the NPI Agreement as well as the context in which the NPI was granted. In August 1990, a series of agreements were negotiated and executed culminating in a refinancing of the Caribou Mine of which the NPI was one of the agreements. The NPI Agreement reads as follow:

EAST WEST CARIBOU MINING LIMITED

For valuable consideration, the sufficiency of which is hereby acknowledged, East West Caribou Mining Limited ("Caribou") hereby grants to East West Minerals N.L. ("East West") a freely assignable 10% net profits interest in the mine known as the Caribou Mine located near Bathurst, New Brunswick as in operation from time to time.

The 10% net profits interest shall be calculated and payable as follows:

(a) subject to paragraph (b), the term "net profits" shall mean the excess of gross revenue of the Caribou Mine from the sale of minerals, metals, concentrates and material mined therefrom over all expenses (other than those of a capital nature) properly incurred, determined for each accounting period in accordance with generally accepted accounting principles and good mining practice applied on a consistent basis; the said expenses shall, not include income taxes paid or payable on the income of the Caribou Mine under any provincial or federal income tax statute or any management fee paid or payable to Bathurst or any affiliate or associate thereof but shall, without limitation, include:

(i) all operating expenses (including transportation, smelting and refining) and such administrative and overhead expenses as are reasonable and necessary to produce the said gross revenues, such administrative and overhead expenses not to exceed 10% of all operating expenses properly incurred, apart from such administrative and overhead expenses;

(ii) all taxes (other than income taxes aforementioned) and **royalties** imposed, charged or levied upon the Caribou Mine and the minerals, metals, concentrates and material mined therefrom whether federal, provincial or otherwise;

(iii) all interest in respect of money advanced to and borrowed by Caribou for the purpose of placing the Caribou Mine into production or the resumption of production; and

(iv) depreciation and amortization of the cost of all equipment, facilities, improvements and deferred expenditures required to develop, mine and process the ore, at such rates as will write off such expenditures and costs pro-rated over the estimated life of the Caribou Mine;

(b) if, in any fiscal year, the expenses referred to in subparagraph (a) hereof exceed the gross revenue for any such year, the excess shall be carried forward and be deducted as an expense from the gross revenue of the subsequent year or years, as the case may be;

(c) within thirty (30) days following the end of each calendar quarter, commencing with the calendar quarter in which the Caribou Mine resumes production, Caribou shall deliver to East West a statement of the net profits, if any, for that quarter, together (subject to paragraph (d) with a cheque in payment thereof (less the amount of any tax required to be withheld) determined as aforesaid. Caribou shall deliver an audited statement of net profits within 120 days of the end of each fiscal year;

(d) notwithstanding the foregoing, payment of all amounts to East West, or any assignees thereof pursuant hereto shall be subordinate to the obligations of Caribou to the National Australia Bank Limited and Westpac Banking Corporation pursuant to the provisions of the **Royalty** Interest Postponement and Subordination Agreement to be dated in August, 1990, the terms of which shall be deemed part of this instrument with the intent that they set out the provisions of subordination in detail and to the Province of New Brunswick (collectively the "Lenders");

(e) Bathurst covenants and agrees that it shall manage the Caribou Mine, or cause the Caribou Mine to be managed, in a proper and professional manner and shall use its best efforts to cause the Caribou Mine to resume full production and thereafter to operate efficiently;

(f) the net profits interest shall terminate and be of no further force or effect and all obligations hereunder, present or future, accrued or not, upon (i) any dissolution, bankruptcy, receivership, winding-up, liquidation, or other similar proceedings in respect of Caribou (whether voluntary or involuntary), (ii) any proposal made by Caribou under the Bankruptcy Act, (iii) any proposed compromise or arrangement in respect of Caribou under the Companies

Creditors Arrangement Act or any applicable provincial legislation, (iv) any distribution of the assets of Caribou or proceeds thereof among its lenders in any matter whatsoever, or, (v) any sale or other disposition or any foreclosure by the Lenders pursuant to any security now or hereafter held by them over any of the assets of Caribou or over any of the shares in the capital of Caribou, whether or not occasioned by any of the foregoing;

(g) without limiting paragraphs (d) and (f) hereof, prior to the date upon which Westpac Banking Corporation and National Australia Bank Limited have been paid in full all amounts payable to them pursuant to the Loan Agreement dated 9 August, 1990, East West or its assigns shall have no right to receive or demand any payment under this instrument; and

(h) any dispute regarding the calculation or payment of net profits shall be settled pursuant to the terms of the Arbitrations Act (**Ontario**) and the parties hereto agree to be bound by any decision reached pursuant to such arbitration.

17 At the time the NPI Agreement was entered into, East West Caribou, East West Minerals and the lenders of East West Caribou, the National Australia Bank Limited and the Province of New Brunswick, entered into two separate subordination agreements. By virtue of section (d) of the NPI Agreement, the Subordination Agreements are incorporated by reference into the NPI Agreement. The Subordination Agreement provides that East West Minerals interest (the 10% NPI) is subordinate to the interests of National and the Province.

18 For ease of reference, I reproduce Section 7 and 17 of the Subordination Agreement which state as follows:

Section 7. Termination of **Royalty** Interest. Each of the Subordinating Parties agree in favour of the Borrower and the Banks that the **Royalty** Interest shall terminate and all rights of the Subordinating Parties thereof, present or future, accrued or not, including all rights of the Subordinating Parties in respect of arrears shall be extinguished upon (i) the institution or commencement of any dissolution, **bankruptcy**, receivership, winding-up, liquidation or other similar proceedings in respect of the Borrower (whether voluntary or involuntary), (ii) any proposal made by the Borrower under the **Bankruptcy** Act, (iii) any proposed compromise or arrangement in respect of the Borrower under the Companies' Creditor Arrangement Act or any applicable provincial legislation, (iv) any distribution of assets of the Borrower or proceeds thereof among its lenders in any manner whatsoever, or (v) any sale or other disposition or any foreclosure by the Banks pursuant to any security now or hereafter held by them over any of the assets of the Borrower or over any of the shares in the capital of the Borrower, whether or not occasioned by any of the foregoing. The subordinating Parties will execute any discharges or termination agreements reasonably required by the Borrower or the Banks in order to evidence such termination.

[emphasis added].

Section 17. Successors and Assigns. This Agreement shall enure to the benefit of and shall be binding upon the Banks, the Subordinating Parties and the Borrower and their respective heirs, executors, administrators, successors and permitted assigns,

[emphasis added]

19 BNC is a successor to East West Caribou and is both bankrupt and subject to the CCAA proceedings. The Fern Trust is a successor to East West Minerals and as such, is the holder of rights by virtue of the NPI Agreement.

20 On July 26, 2006, an Asset Purchase Agreement was concluded whereby BWR, through its wholly-owned subsidiary CanZinco, sold the Caribou Mine to Blue Note Mining Inc. which in turn shortly thereafter, conveyed the Caribou Mine to its wholly-owned subsidiary Blue Note Caribou Mine. Howard Miller, in his affidavit, described the Fern Trust's reaction upon hearing of the transaction:

Commencing on hearing the news about potential sale of the Caribou Mine by Breakwater in 2006, the Fern Trust's counsel corresponded with George Cooper, counsel to Blue Note Mining and its affiliates (collectively, the "Blue Note Companies"), reminding him about the existence of the NPI and the fact that the NPI constituted an interest in the Caribou Mine. The Blue Note Companies denied that the NPI was a proprietary interest in favour of the Fern Trust. Moreover, the Blue Note Companies took the position that they never had "actual notice" of the NPI and since it was not registered on title, the NPI did not continue to constitute a proprietary interest in the Caribou Mine.

21 Litigation ensued between the Fern Trust and Blue Note Mine and Blue Note Caribou. At issue in the litigation was whether the NPI constituted an interest over the mine and whether Blue Note was bound by the terms of the NPI as a successor in title. The result of the litigation is relevant to the issues raised in the present motion.

22 Justice Rideout of the Court of Queen's Bench of New Brunswick, in a decision reported at (N.B. Q.B.), which was subsequently affirmed by the New Brunswick Court of Appeal [2009 CarswellNB 107 (N.B. C.A.)], decided that the NPI Agreement runs with the land and that BNC must abide by the NPI Agreement. In his decision Justice Rideout states the following at paragraph 18:

The NPI was reproduced in its entirety at paragraph 7 of these reasons. It contains the following wording:

In the opening paragraph are the words,

- ... hereby grants to East West Minerals N.L. ("East West") a freely assignable 10% net profit interest in the mine known as the Caribou Mine ...

- (d) notwithstanding the foregoing, payment of all amounts to East West, or any assignees thereof pursuant hereto shall be subordinate ...

- (g) deals with paying off lenders and states that until the lenders are paid in full; ... East West or its assigns shall have no right to receive or demand any payment under this instrument ...

[underlining added]

There are provisions which also deal with the situation where the Mine becomes insolvent and the effects on the NPI.

23 Justice Rideout writes the following at paragraphs 34, 35, 40 and 44:

34. The authorities indicate that there are no special words or incantations which create an interest in a mine. In the NPI are the words "grant" and "in the mine" but there are no other words that are typically found in a conveyance of an interest in land, such as; bargain, sell, assign, transfer, set over and the like. The words "freely assignable" do not establish any intention to create an interest in land as they can relate to either situation. However, I believe the words "grant" and "in the mine" do establish an interest in land for the reasons outlined later.

35. I am satisfied that the interest over which the NPI is applicable is an interest in land. It is dealing with a net profit arising from the mine itself; consequently, the NPI is carved out of an interest in land. This satisfies the second test in Dynex.

[...]

40. ...I, therefore, have no doubt on this issue, as to what the judgment of the Court would be if the matter proceeds to trial. I believe a Court would conclude the NPI runs with the mine, based solely on the wording in the instrument.

[...]

44. I declare that the Merlin Group Securities Limited has a 10% net profits interest which runs with the Caribou Mine.

Consequently, the issues that were raised before Justice Rideout are now settled law.

24 In his affidavit in support of the present application, Robert C. Smith states that as monitor he requires direction as to the effect of paragraph (f) of the NPI. At paragraphs 18 and 19 of his November 19, 2009 affidavit, Mr. Smith described the principle issues raised by the Fern Trust in regards to the NPI Agreement:

> The defined term "Caribou" in paragraph (f) of the NPI referred to above means East West Caribou Mining Limited, now known as CanZinco Ltd., and was the predecessor in title to the Sale Assets, which have since passed to BNC along with, as the Decision of Justice Rideout confirmed, the NPI. CanZinco Ltd.'s transfer of the NPI resulted from an Asset Purchase Agreement dated July 26, 2006, a copy of which is attached and marked Exhibit "Z", without schedules or exhibits thereto, and a General Conveyance and Assumption of Liabilities Agreement dated July 26, 2009, a copy of which is attached and marked as Exhibit "AA".
>
> In my capacity as Monitor and Trustee and in order to complete the Transaction contemplated by Sale Agreement, I respectfully seek direction from this Honourable Court as to whether the NPI shall continue to bind any of the Sale Assets.
>
> The issue raised by the present motion is whether or not the NPI Agreement is extinguished by virtue of the insolvency of BNC.

25 The NPI Agreement and the Subordination Agreement provide that the NPI will terminate with the **bankruptcy** of "Caribou" and the "Borrower" respectively. These terms refer to East West Caribou Mining Limited who is the predecessor in title to BNC. As previously mentioned, BNC is now bankrupt. As early as in his April 21st, 2009 memorandum, the monitor stated his understanding of the positions taken by the parties involved in the BNC proceedings under the CCAA where he states:

> Without making comment on the positions, the Monitor hereafter provides a short form view of the positions taken by the various parties involved in BNMC. It is fully anticipated that the legal arguments will be far more extensive than set out below. Should there be a proposed sale of the mine, these matters will be brought to the Court for consideration and decision.
>
> The Fern Trust takes the position that the NPI takes priority over any sale of the assets and will constitute an obligation of the subsequent owner of the property.
>
> The Company takes the position that at Paragraph f of the NPI, it is clearly stated that the NPI shall terminate on the insolvency of Caribou. The Company takes the position that the Court has interpreted "Caribou" as the mine, and that as a result of the insolvency of Blue Note Caribou Mines Inc. the NPI is at an end.
>
> The Secured Lenders of BNCM take the position that the NPI is subordinate to the interest of the lenders and can be foreclosed by action of the Lenders or by declaration of the Court in the CCAA proceeding.

26 The main issue raised in this Application in regards to the NPI is whether the NPI Agreement is terminated as a matter of contractual interpretation. Is "Blue Note" to be substituted for "Caribou" in paragraph f) of the NPI or put in another way is paragraph (f) of the NPI Agreement triggered by the insolvency of BNC?

27 The Applicant takes the position that on a plain reading of paragraph (f) of the NPI Agreement, it is clear that the NPI Agreement is extinguished because BNC is subject to proceedings under the BIA and the CCAA. It is argued that as a result, Fern Trust's interest, if any, in the Sale Assets or to any profits to be derived as a result therefrom or as a result of being a party to the NPI Agreement has been terminated and/or are of no further force and effect.

28 In its written submission, the Applicant states its position in the following terms:

> The NPI Agreement, including paragraph (f), contemplates that from time to time the Caribou Mine will go in and out of operation, under the control and ownership of various parties, and may, from time to time, be insolvent or subject to insolvency proceedings.
>
> BNC, as the current owner subject to the NPI Agreement is entitled to rely on paragraph (f) of the NPI Agreement. To hold otherwise permits the Fern Trust to take advantage of all benefits of the NPI Agreement without accepting any obligations or burdens of the NPI Agreement.
>
> Both the NPI Agreement and the Subordination Agreements contemplate the termination of the NPI Agreement upon, inter alia, the **bankruptcy** or insolvency of East West Caribou or it's successors in title.
>
> On a plain reading of paragraph (f) of the NPI Agreement, it is clear that the NPI Agreement is extinguished because, inter alia, BNC is subject to proceedings under the BIA and the CCAA. Fern Trust's interest, if any, in the Sale Assets or to any profits to be derived as a result therefrom as a result of being a party to the NPI Agreement have been terminated and/or are of no further force and effect.

29 Maple Minerals takes much the same position. It states that because the NPI runs with the lands, Blue Note (as a successor in title to the Caribou Mine) has stepped into the shoes of the original grantor of the NPI and is subject to the terms of the NPI Agreement, which is the originating document in relation to the NPI. The Fern Trust, they argue, cannot now plausibly assert that the clauses which benefit it run with the lands whereas other clauses of the NPI Agreement do not run with the lands. It is further submitted by Maple Minerals that the entire NPI Agreement and Subordination Agreement run with the lands, not just the clauses that benefit the Fern Trust.

30 In its written submission, Maple Minerals further argues at paragraphs 37 to 40:

> 37. Fern Trust alleges that the termination clause within paragraph (f) of the NPI Agreement applies only to East West Caribou Mining Limited, and not to the current owner of the Caribou Mine. This argument contradicts the findings by the New Brunswick Court of Appeal that the NPI is an interest that runs with the Caribou Mine. The Fern Trust cannot on the one hand assert that the NPI runs with the land, and on the other hand assert that it is a contractual right that is limited to the signatory of the NPI Agreement. If paragraph (f) of the NPI Agreement is to have any effect, it is that the current owner of the Caribou Mine now subject to the NPI is the party bound by the clauses in that agreement, and therefore, paragraph (f) is triggered by the **bankruptcy** of insolvency of Blue Note.
>
> 38. In addition to paragraph (f) of the NPI Agreement, section 7 of the Subordination Agreement provides that the Subordinating Parties (which includes the grantee of the NPI, presently the Fern Trust) agree that the **Royalty** Interest (which includes the NPI) terminates upon the **bankruptcy** of the Borrower (East West Caribou Mining Limited). In addition, sections 2(2) and 17 of the Subordination Agreement contemplate assignment of the agreement by the Borrower. That the terms of the Subordination Agreement are incorporated into the NPI Agreement indicates that the terminating sections are not limited to the insolvency of East West Caribou Mining Limited and apply to the **bankruptcy** or insolvency of Blue Note.
>
> *Smith Affidavit, Exh. "Y"*
>
> 39. Further, Rideout J. noted that the NPI Agreement contains "*provisions which also deal with the situation where the Mine becomes insolvent and the effects on the NPI.*" This comment suggests that it is the financial situation of the current owner of the Caribou Mine which is targeted by the termination provisions.
>
> *Smith Affidavit, Exh. "U" at para. 17*

> 40. Blue Note, as the current owner of the Caribou Mine, is obligated to pay the NPI, which obligation runs with the Caribou Mine. Because the NPI Agreement runs with the lands, so do its termination provisions.

31 In short, it is argued that the insolvency of BNC triggers paragraph 7 of the NPI Agreement and consequently the NPI Agreement is terminated and of no further force or effect.

32 The Fern Trust, for its part, takes the position that when the NPI Agreement is properly interpreted, it is clear that the insolvency of BNC does not trigger the termination clause found in paragraph (f) of the NPI Agreement. The Fern Trust submits that by using the plain and ordinary meaning of the words used in the NPI as well as considering all of the surrounding circumstances, no other interpretation of the NPI would be appropriate, nor would it respect the true intention of the parties to the agreement. It is further submitted that there is no ambiguity in paragraph (f), that "Caribou" simply means "Caribou", not its successors and assigns and consequently the termination clause found in paragraph (f) is not triggered by the insolvency of BNC.

33 The Fern Trust also submits that as a matter of real property law, it would be incorrect to substitute "Blue Note" for "Caribou" in paragraph (f) of the NPI.

Analysis

The Law — Contractual Interpretation

34 The law regarding contractual interpretation is well settled in Canada. As recently stated by the New Brunswick Court of Appeal in *Pharmacie Acadienne de Beresford Ltée v. Beresford Shopping Centre Ltd./Ltée*, [2008] N.B.J. No. 45 (N.B. C.A.):

> The objective of contractual interpretation is the identification of the true intent of the parties at the time they entered into the contract. That intention must be ascertained by reference to the meaning of the words as used by the contracting parties ... More often than not, the context plays an influential role in shaping that meaning.

In *Pharmacie*, the Court of Appeal adopted its previous decision in *Irving Pulp & Paper Ltd. v. C.E.P., Local 30* [2002 CarswellNB 107 (N.B. C.A.)] wherein it was stated:

> 22. It is accepted that the task of interpreting a collective agreement is no different than that faced by other adjudicators in construing statutes or private contracts... In the contractual context, you begin with the proposition that the fundamental object of the interpretative exercise is to ascertain the intention of the parties. In turn the presumption is that the parties are assumed to have intended what they have said and that the meaning of a provision of a collective agreement is to be first sought in the express provisions. In searching for the parties' intention, text writers indicate that arbitrators have generally assumed that **the provision in question should be construed in its normal or ordinary sense unless the interpretation would lead to an absurdity or inconsistency** with other provisions of the collective agreement... In short, the words of a collective agreement are to be given their ordinary and plain meaning unless there is a valid reason for adopting another. At the same time, words must be read in their immediate context and in the context of the agreement as a whole. Otherwise, the plain meaning interpretation may conflict with another provision.

35 In *Orbus Pharma Inc. v. Kung Man Lee Properties Inc.*, [2008] A.J. No. 1430 (Alta. Q.B.), the Court of Queen's Bench of Alberta described the principles of contractual interpretation as follows:

> The numerous principles of contractual interpretation have a common aim — to assist the court in finding an interpretation that reflects and promotes the intention of the parties at the time they entered into the contract: *Consolidated Bathurst Export Ltd. v. Mutual Boiler and Machinery Insurance Co.*, 1979 CanLII 10 (S.C.C.), [1980] 1 S.C.R. 888.

> The "cardinal interpretive rule" of contracts is that "the court should give effect to the intentions of parties as expressed in their written document:" *Manulife Bank of Canada v. Conlin*, 1996 CanLII 182 (S.C.C.), [1996] 3 S.C.R. 415 at para. 79. The intent of the parties is to be determined by reference to the words they used in drafting the contract: *Eli Lilly & Co. v. Novopharm Ltd.*, 1998 CanLII 791 (S.C.C.), [1998] 2 S.C.R. 129 at para. 54. Therefore, the contract itself and the words it contains are what are to be considered. As Iacobucci, J. went on to state in *Eli Lilly* at para. 55, "Indeed, it is unnecessary to consider any extrinsic evidence at all when the document is clear and unambiguous on its face." The interpretation of the contract is to be conducted on an objective basis, that is, through a determination of what a reasonable person would infer from the words used.

36 The case law is consistent in providing that words of a contract must be given their plain and ordinary meaning unless, to do so, would result in an absurdity. As stated in *Manulife Bank of Canada v. Conlin* [1996 CarswellOnt 3941 (S.C.C.)] (supra), "the Court will deviate from the plain meaning of the words only if a literal interpretation of the contractual language would lead either to an absurd result or a result which is 'plainly repugnant to the intention of the parties'".

37 The Applicant seeks direction from this Court as to whether the NPI continues to bind any of the sale assets. Is the NPI Agreement extinguished by virtue of the insolvency of BNC? The Applicant is also seeking that this Court exercise its inherent jurisdiction under the CCAA and terminate the NPI or render the NPI is of no further force or effect. The issue raised by the present motion whether or not the NPI is extinguished by the insolvency of BNC, or otherwise stated, does the insolvency of BNC the successor in title to East West Caribou trigger paragraph (f) of the NPI Agreement.

38 I have read carefully the NPI Agreement as well as the Subordination Agreement which as mentioned is incorporated by reference in the NPI Agreement. From my reading of the NPI Agreement, I have to conclude that paragraph f) of the NPI Agreement is not ambiguous and must be interpreted by using the plain and ordinary meaning of the words used by the parties to the Agreement. My reading of the NPI Agreement leads me to conclude that in fact, "Caribou" means "Caribou". Caribou is a defined term which means East West Caribou Mining Ltd. It is clear in my view that when the parties wanted to refer to "Caribou", they did so and when they intended to refer to the Caribou Mine, they also clearly did so. Any reasonable interpretation of the NPI Agreement and the Subordination Agreement cannot somehow be interpreted to now mean Blue Note Caribou. In my opinion, "Caribou" clearly means East West Caribou as defined. The parties to the Agreement did not state that it should include its successors and assigns as suggested by those who hold the contrary view. Had the parties to the NPI Agreement wanted paragraph (f) to apply to any entity other than East West Caribou Mining Ltd., the agreement could have said so and in my view, would have said so. It does not. In my opinion, it would be contrary to the rules of contractual interpretation to read in terms that were not intended by the parties. The provisions of the NPI must also be read in considering the provisions of the Subordination Agreement which are expressly incorporated by reference to the NPI Agreement. Nowhere in the Agreement does the NPI refer to "Caribou", its successors or assigns. It is clear that the parties to the NPI Agreement chose where and where not to refer to assignees in drafting the Agreement.

39 Furthermore, I am of the view that Section 7 of the Subordination Agreements applies only to the insolvency of the "Borrower" which is defined as East West Caribou Mining Limited. Section 7 of the Subordination Agreements does not provide that it applies to the Borrower's successors and assigns. I agree with the submission made by counsel for the Fern Trust that "when the termination provision of the NPI Agreement is interpreted in light of the similar provisions in the Subordination Agreements, it is clear that in the same way that "Borrower" means only East West Caribou Mining Limited, "Caribou" means only East West Caribou Mining Limited."

40 Simply put, I am in agreement with the position taken by the Fern Trust that the insolvency of Blue Note did not trigger paragraph (f) of the NPI, that the insolvency of BNC did not terminate the NPI. As a matter of contractual interpretation, I conclude that the term "Caribou", for purposes of paragraph f) of the NPI, means East West Caribou Mining Ltd. (now CanZinco Ltd.) and does not mean Blue Note, the successor in title to the Caribou Mine. In my view, when considered in accordance with its plain and ordinary meaning, the proper interpretation of paragraph (f) of the

NPI Agreement leads to the conclusion that "Caribou" means only East West Caribou Mining Limited. I would add that there is no need to consider the extrinsic evidence in the instant case, given my finding that the NPI Agreement is not ambiguous.

41 On the whole, I conclude that the NPI Agreement is not terminated by the operation of paragraph (f) of the NPI Agreement. The Applicant contends that the NPI Agreement was held in prior judicial decisions to be binding on its successors in title to the original grantor including BNC. PWC further states that it is clear from Justice Rideout and the decisions of the Court of Appeal that the NPI Agreement runs with the lands and forms an interest in the Caribou mine itself. I have reviewed the decision of Justice Rideout as well as the decision of the Court of Appeal and with respect, it is clear that Justice Rideout, in rendering his decision, was not required to determine the effect of paragraph (f) contained in the NPI and in my view, did not do so. It was simply not an issue that Justice Rideout was asked to determine and it cannot be read from his decision that he addressed the issue of paragraph (f) of the NPI. For those reasons, the previous litigation and decision cannot be relied upon to conclude that paragraph (f) was in fact triggered by the insolvency of BNC. As a result, the Applicant cannot rely on the principle of *res judicata* in the present circumstances. Finally, I wish to add that I am not prepared to "vest out" the interest of the Fern Trust as requested by the Applicant. I have not been persuaded that I should exercise my inherent jurisdiction under the CCAA and conclude that the NPI Agreement should be terminated or of no further force or effect.

Disposition

42 As a result, I conclude that the Fern Trust's interest in the Mine was not terminated by the insolvency of BNC Mine. Furthermore, I am not prepared to expunge the interest of the Fern Trust by virtue of any inherent jurisdiction which I may have under the CCAA in order to grant a clear title to the purchaser as requested by the applicant to this motion.

Breakwater Resources

43 As mentioned, BWR opposes the motion. By way of a motion of its own BWR claims a 20% property interest in the Caribou Mine. BWR also seeks an order that it be allowed to exercise a Right of First Refusal obtained by virtue of a Joint Venture Agreement which BWR was deemed to have entered into with Blue Note upon the exercise of their option to convert pursuant to a convertible debenture issued to BWR by Blue Note Mining.

The Background

44 CanZinco is a wholly owned subsidiary of BWR and is the previous owner of the Caribou Mine. On July 26, 2006, CanZinco sold the Mines to Blue Note Metals Inc. (now Blue Note Mining Inc. "Blue Note"). As part of the consideration for acquiring the Mines and at the direction of CanZinco, Blue Note issued to Breakwater an Unsecured Subordinated Convertible Debenture dated August 1, 2006 in an amount of $15,000,000.00 CDN (the "Debenture") and entered into, with Breakwater, a Marketing Agency Agreement and a Net Smelter **Royalty** Agreement (the NSR Agreement).

45 David Langille, Vice-president, Financial and Chief Finance Officer of BWR, swore an affidavit on behalf of BWR on January 5 th , 2010. In its written submission, BWR relates the relevant portions of Mr. Langille's affidavit and discusses the terms of the debenture, the Rights of First Refusal and the Trust Indenture between Blue Note, Blue Note Caribou and Computershare. The written submissions of BWR provides in part as follows:

> By virtue of Article 3.1(a) of the Debenture, Breakwater was granted an option (Conversion Option) to convert the Debenture into a twenty (20%) interest in the mineral properties and mine facilities which comprise the Caribou and Restigouche Mines in New Brunswick (the "Real Property").
>
> Article 3.2(b) of the Debenture provided that upon Breakwater exercising its Conversion Option, the parties were deemed to have entered into, and their rights governed by, a joint venture agreement substantially in the form attached to the Debenture (the "Joint Venture Agreement").

On May 4, 2007 Blue Note and Blue Note Caribou entered into a trust indenture (Trust Indenture) with Computershare Trust Company of Canada (Computershare). The Trust Indenture provided for the issuance by Blue Note and Blue Note Caribou of the senior secured notes and provided for the granting of a debenture in favour of Computershare as security (the "Blue Note Debenture"). The terms Trust Indentures governs the rights under the Blue Note Debenture. Section 4.16 of the Blue Note Debenture stated in part as follows:

> This Debenture is entered into pursuant to a note indenture made between the Obligor, as borrower, the Lender as lender and Blue Note Caribou Mines, Inc. as guarantor dated on or about May 2, 2007 (as the same may be amended, supplemented, or replaced from time to time (the "Note Indenture")... Where a conflict exists between the provisions of this Debenture and the Note Indenture, the Note Indenture shall govern...

The Note Indenture which is referred to is the Trust Indenture.

The Trust Indenture expressly contemplated the existence of the prior rights of Breakwater with respect to the Conversion Option. In particular, in the Trust Indenture, the Debenture is defined as the "Breakwater Note" and the definition of "Permitted Encumbrance" contained in the Trust Indenture includes at clause (k):

> (k) the rights contained in Article 3 of the Breakwater Note...

The intention of the parties to the Trust Indenture as stated in section 14.6 of the Trust Indenture was stated as follows:

> It is the intention of the parties that the Trustee will, among other things, have a first priority Security Interests, subject to Permitted Encumbrances, over all the Secured Assets.

Paragraph 8.2(b) of the Trust Indenture prohibits Blue Note Caribou from conveying or transferring any part of the assets of Blue Note Caribou including the Mines other than:

> ...(ii) in accordance with Article 3 of the Breakwater Note

Paragraph 8.2(i) of the Trust Indenture similarly prohibits any sale or disposition of the business of Blue Note Caribou or any of its subsidiaries other than as provided under Article 3 of the Breakwater Note.

The Trust Indenture expressly permitted the transfer to Breakwater pursuant to the Conversion Option as contemplated under Article 3 of the Debenture. Section 14.5 of the Trust Indenture further provides that upon a sale or transfer of any assets permitted under the Trust Indenture, Computershare is expressly required to release such assets from its security interest. Section 14.5 states:

> Upon the sale or transfer of any assets permitted under this Indenture, the Trustee shall, at the request and expense of the Corporation, execute and deliver to the Corporation or BNC such deeds or other instruments as may be necessary to release such asset from the Security Interests created by the Security Documents provided that such deeds or other instruments are in form and substance satisfactory to the Trustee Counsel, both acting reasonably.

Based on the terms of the Trust Indenture, Computershare was clearly aware of, and acknowledged the existence of, the Conversion Option and agreed to it constituting an encumbrance on the assets of Blue Note Caribou. Furthermore, the Trust Indenture permitted the transfer to Breakwater on exercise of the Conversion Option and provided that, upon the same occurring, the relevant assets were to be released from the security interest.

By an agreement dated June 29, 2007 (the "Transfer Agreement"), Blue Note transferred its interest in the Mines to its subsidiary corporation, Blue Note Caribou Inc. ("Blue Note Caribou"). Breakwater was not given notice of the transfer until February 28, 2008.

In the Transfer Agreement, Blue Note Caribou specifically acknowledged Breakwater's Conversion Option and covenanted to provide Breakwater with their appropriate interests in the event that Breakwater exercised it. Further, in the event that Breakwater exercised its Conversion Option, Blue Note Caribou agreed with Blue Note to enter into the Joint Venture Agreement. The Transfer Agreement states, in part:

> ...WHEREAS pursuant to the Debenture, Breakwater has the right to convert the Debenture into a 20% interest in the Mines which, if exercised, would be governed by a joint venture agreement, the form of which is appended to the Debenture (the JV Agreement);
>
> AND WHEREAS the Mines were purchased by Blue Note on August 1, 2006 and Blue Note has transferred the Mines to Blue Note Caribou Mines Inc. ("BN Caribou"), a wholly-owned subsidiary of Blue Note;
>
> AND WHEREAS this agreement is entered into pursuant to Article 11 of the Debenture;
>
> NOW THEREFORE THIS AGREEMENT WITNESSES that for good and valuable consideration, the receipt and sufficiency of which is acknowledged by the undersigned and, by acceptance of this Agreement, by Breakwater, it is agreed by the undersigned and Breakwater as follows:
>
> . . .
>
> 2. Acknowledgement and Covenant. BN Caribou hereby acknowledges Breakwater's Property Interest Conversion Option rights under the Debenture and hereby covenants to provide Breakwater with the Holder's Interest in the Properties in the event that Breakwater exercises it Property Interest Conversion Option pursuant to Subsection 3.11(a) of the Debenture.
>
> 3. JV Agreement. BN Caribou and Blue Note hereby agree that in the event that Breakwater exercises its Property Interest Conversion Option, the JV Agreement will be entered into between BN Caribou and Breakwater and all references in the JV Agreement to Blue Note shall be reverences to BN Caribou.
>
> Breakwater exercised its Conversion Option on August 29, 2008 requiring Blue Note to transfer to it a 20% interest in the Mines, obligating Computershare to provide a discharge with respect to such transferred interest and deeming the parties to have entered into the Joint Venture Agreement.

46 Following the exercise of the conversion option by BWR on August 29, 2008, there were differences of opinion among BNC, BNM and BWR as to who should execute the Joint Venture Agreement. As such, an action was commenced on the 9th of December, 2008 by BWR against Blue Note Mining, Blue Note Caribou. On January 30th, 2009, BWR in its amended Statement of Claim, made the following assertions:

> By an Amended Notice of Action with Statement of Claim Attached dated January 30, 2009, Breakwater amended its Statement of Claim to seek relief based on, *inter alia*, the following allegations:
>
> • Blue Note failed to cause title to the Mines to be recorded in Breakwater's name in proportion to Breakwater's interest as practicable after the Date of Property Interest Conversion, constituting a violation of Article 3.2(d) of the Debenture;
>
> • Blue Note failed to act in accordance with the terms of the Joint Venture Agreement subsequent to the establishment of the Joint Venture Agreement on August 29, 2008 and delayed executing the Joint Venture Agreement until October 17, 2008;
>
> • Blue Note failed to play all Costs (as defined in the Joint Venture Agreement) incurred promptly as and when due, and to keep the Mines free of all liens and indebtedness (except Permitted Liens and Permitted Indebtedness, as defined in the Debenture);

• Blue Note failed to proceed with diligence to contest or discharge the mechanics' liens contrary to Article 6.4(c) of the Joint Venture Agreement; and

• Blue Note breached its obligation as operator of the Mines pursuant to Article 16 of the Joint Venture Agreement by unilaterally initiating a care and maintenance program at the Mines which constituted the suspension or termination of Mining Operations (as defined in the Joint Venture Agreement) under the Joint Venture Agreement without notice to and consultation with Breakwater.

47 The evidence indicates that Blue Note has acknowledged Breakwater's 20% interest in the Mines on numerous occasions. On September 3, 2008, Blue Note issued a press release entitled "Blue Note's Caribou has a new partner". In the press release, Blue Note stated:

> Montreal, QC-September 3, 2008 — Blue Note Mining is pleased to report that Breakwater Resources has exercised its right pursuant to the terms of the Unsecured Subordinated Convertible Debenture issued by Blue Note dated August 1 st , 2006 to convert the Debenture in exchange for a twenty percent (20%) interest in the mineral properties and mine facilities which comprise the Caribou and Restigouche mines in New Brunswick now owned by Blue Note's subsidiary, Blue Note Caribou Mines Inc.
>
> Having the Debenture surrendered by Breakwater, Blue Note Caribou Mines and Breakwater are now contractually obligated to enter into a joint venture agreement which releases Blue Note and Blue Note Caribou Mines from all liability under the Debenture.
>
> "We feel that this decision validates everything we always have believed about the Caribou mines," Said Michael Judson, President and Chief Executive Officer of Blue Note Mining, "it is a high quality asset, and Breakwater understands its value."

48 At paragraph 44 of his affidavit, David Langille further explains how BNC acknowledged BWR's 20% interest in the following terms:

> In its annual audited financial statements for the years ending December 31, 2007 and December 31, 2008 and the report of its auditor, Ernst & Young dated March 31, 2009 as filed on the System for Electronic Document Analysis and Retrieval of the Canadian Securities Administrators, Blue Note refers to, and accounts for, Breakwater's 20% interest in the property used in connection with the Mines. At Note 12 to such financial statements Blue Note states:
>
> > 44. As at August 29, 2008, Breakwater Resources Ltd. exercised the conversion option to obtain a 20% interest in the Caribou Mines. This conversion resulted in a loss on conversion of $14,949,161, which represents the difference between 20% of the carrying value of the Caribou Mines as of August 29, 2008 and $11,229,285, the carrying value of the Debenture at that date... The Corporation has accounted for this conversion as a sale of a portion of their mining properties, constituting a business and therefore has accounted for the investment in the Caribou Mines by Breakwater Resources Ltd. as a non controlling interest.
> >
> > 45. Furthermore, in the same financial statements Blue Note accounted for property costs on a 20%/80% basis and reduced its actual costs incurred by creating a "non-controlling interest" account representing Breakwater's interest. Blue Note also consistently accounted for and disclosed this "non-controlling interest" account in each of the interim financial statements for the quarters ended March 31, 2009, June 30, 2009 and September 30, 2009, confirming Blue Note's acknowledgment that the Joint Venture Agreement continued in force and effect.

49 In his affidavit, Mr. Langille also discusses the issue surrounding the Rights of First Refusal as follows:

> Articles 14 and 15 of the Joint Venture Agreement provide for rights of first refusal in favour of Breakwater (the "Right of First Refusal") in connection with any proposed sale of the Mines. Articles 14 and 15 of the Joint Venture

Agreement provide for rights of first refusal in favour of Breakwater (the "Right of First Refusal") in connection with any proposed sale of the Mines. Specifically, Articles 14.1 and 15.1(b) of the Joint Venture provide as follows:

> 14.1 If a party (hereafter in this subparagraph 14.1 called the "Vendor") shall wish or seek to sell, assign, transfer, convey or otherwise dispose of all or part of its Interest at any time during the currency of this Agreement, the other parties then having an Interest (hereafter in this subparagraph 14.1) called the "Purchasers") shall be entitled to a right of first refusal in respect thereof...
>
> . . .
>
> 15.1 (b) Within 45 days after receipt of the Sale Notice, Breakwater shall have the right (the "Right of First Refusal") to purchase the Property from Blue Note on payment by Breakwater to Blue Note of the same Sale Price that Blue Note specified in its Sale Notice. Where Breakwater determines to exercise its Right of First Refusal, then, on the Sale Date, Breakwater shall deliver or cause to be delivered to Blue Note payment of the total Sale Price for the Property.

. . .

Pursuant to Articles 14 and 15 of the Joint Venture Agreement, Breakwater possesses Rights of First Refusal in connection with any proposed sale of Blue Note Caribou's Interest, including any sale of its interest in the Mines.

50 On July 17, 2009, PWC acting as Monitor, advised BWR that it could not claim to be a creditor of Blue Note Mining as it had converted its interest into a proprietary interest. On that issue, at paragraph 82 of his affidavit, David Langille states:

> 82. By e-mail dated July 10, 2009, a copy of which is attached hereto as Exhibit "UU", Breakwater, through its solicitors, filed a Proof of Claim with PwC based in Montreal, Quebec in the matter of the Plan of Arrangement of Blue Note in separate proceedings under the CCAA. As part of its claim, Breakwater included a claim for monies owing in relation to the Debenture in the amount of $15,000,000.00. PwC, acting in its capacity as Monitor in the matter of the Plan or Arrangement of Blue Note, disallowed this claim, finding that Breakwater had surrendered its position as a creditor, having converted the indebtedness owed to it into a proprietary interest in the Mines. By notice dated July 17, 2009, Christian Bourque of PwC advised that "Breakwater Resources Ltd. cannot claim to be a creditor of Blue Note Mining Inc...as it can no longer claim the principal amount of the Debenture...". The effect of PwC's disallowance of the Breakwater Proof of Claim in the Blue Note CCAA proceedings was to disallow Breakwater's claim to the amount owing pursuant to the Debenture of the basis that Breakwater had exercised its Property Conversion Option. Breakwater did not appeal this disallowance. By denying its status as a creditor under the Debenture, PwC acknowledged Breakwater's status as a 20% owner and Joint Venture Partner pursuant to the Debenture and the Joint Venture Agreement. PwC must not be permitted to take a different approach in the current proceedings, the effect of which would be to deprive Breakwater of all of its rights under both the Debenture and the Joint Venture Agreement.

51 Subsequently BWR filed another Proof of Claim, this time in the amount of approximately $63, 000.00, which was also disallowed.

52 Finally, there is the issue of the security taken by Computershare on May 4, 2007 with Blue Note and Blue Note Caribou on the assets of Blue Note Caribou. In his affidavit, David Langille explains in part BWR's position as follows:

> Based on the terms of the Trust Indenture, Computershare was clearly aware of, and acknowledged the existence of, the Property Interest Conversion Option and agreed to it constituting an encumbrance on the assets of Blue Note Caribou. Furthermore, the Trust Indenture permitted the transfer to Breakwater on exercise of the Property Interest Conversion Option and provided that, upon the same occurring, the relevant assets were to be released from the security interest. The parties to the Trust Indenture and in particular PwC, as agent for Computershare,

cannot deny Breakwater's prior interest and, in light of section 14.5, cannot rely on the failure to release the security interest of the Trust Indenture in order to defeat Breakwater's prior interest.

The intention of the parties to the Trust Indenture is most clearly enunciated in section 14.6 of the Trust Indenture where it is stated:

> It is the intention of the parties that the Trustee will, among other things, have a first priority Security Interests, subject to Permitted Encumbrances, over all the Secured Assets.

The Property Interest Conversion Option, as a Permitted Encumbrance (as defined in the Trust Indenture), was thus clearly intended to have priority over the interests arising under the Trust Indenture and PwC is estopped from denying such intent.

53 The issues raised by BWR's motion are whether or not BWR has a valid 20% interest in the mine and whether BWR has a Right of First Refusal by virtue of the operation of the Joint Venture Agreement and which they argue, they should be entitled to now exercise in relation to the Stage II part of the Sale Agreement reached between the PWC and Maple Minerals.

The 20% Property Interest Issue

54 I will now deal with the issue of the 20% property interest claimed by BWR in the stage II part of the transaction. PWC argues that BWR is not entitled to a 20% interest in the property in the Caribou Mine.

55 While I agree that BWR has no right to claim any interest in the Stage I portion of the sale to Maple Minerals, I cannot agree with the Applicant and Maple Minerals that BWR has no proprietary interest in the Caribou Mine.

56 With respect to the real property, I am unable to agree with the Applicant and Maple Minerals that BWR has no property rights in the Caribou Mine or that its interest should be "vested out". In my view, by converting the debenture on August 29th, 2008, BWR transformed its interest as an unsecured creditor to that of a property interest holder in the mines. PWC disallowed the claim filed by BWR stating that it was no longer a creditor on the basis that BWR had exercised its property conversion option pursuant to the debenture. It is undisputed that BWR exercised its option in order to convert from whatever interest it had to become a property interest holder. Clearly the effect of the exercise of the Property Interest Conversion by BWR was that BWR became the holder of a 20% interest in the real property and the date of conversion is effective August 29, 2008. Breakwater's 20% interest in the mines was acknowledged by Blue Note on several occasions. First, there was the September 3rd press release confirming that BWR had exercised its right to convert the debenture in a 20% interest in the mineral properties and mine facilities of the Caribou and Restigouche Mines. Blue Note reflected the 20% proprietary interest in the mine in their subsequent audited financial statements and acknowledged that BWR had a 20% proprietary interest in the mines. There is no doubt in my view that BWR as of August 29, 2008 was no longer a creditor, but had become a 20% holder of a proprietary interest in the mines. As a result, I conclude that BWR has a valid 20% proprietary interest in the Caribou Mines.

Right of First Refusal Issue

57 BWR also seeks an order declaring that it possesses a Right of First Refusal pursuant to articles 14.1 and 15(1)a of the Joint Venture Agreement. It is argued that as a result of the provisions contained in the Joint Venture Agreement, this court should issue an order declaring the BWR has the right to purchase the real property on the same terms and conditions as those specified in the agreement of September 30, between BNC and Maple Minerals.

58 While it is clear that BWR did commence an action in December 2008 seeking inter alia to enforce its rights by virtue of the Joint Venture Agreement, including the Rights of First Refusal contemplated by the Joint Venture Agreement, it is equally clear that the action was stayed by the Initial order of February 20, 2009. It is one thing to find on the evidence before this Court that BWR has 20% property interest in the mines, it is quite another to conclude on the record as it is

constituted that the Joint Venture Agreement is valid and enforceable in accordance with its terms. I am not prepared to conclude that Joint Venture Agreement is valid and enforceable based on the record before me. That question cannot and should not be answered by these motions as the record does not allow for a determination of this issue and as result the relief sought by BWR as to the exercise of its Right of First Refusal cannot and should not be granted.

59 I will now discuss the issues raised by the Note indenture of May 4th, 2007 signed by Computershare, Blue Notes Mining Inc. and Blue Note Caribou Mines Inc. Upon review of the record as a whole, I conclude that Computershare's security is subject to the interest of BWR which on August 29, 2008 exercised its conversion option pursuant to the terms of the debenture. This was clearly a permitted encumbrance which Computershare had agreed to. The intention of the parties was clearly stated in the Note Indenture, namely "That the Trustee (Computershare) will, among other things, have a first priority Security Interest, subject to permitted encumbrances, over all secured assets". In my view, Computershare cannot extinguish the rights by virtue of power of sale proceedings pursuant to the *Property Act*. I recognize that this finding is contrary to the assertion made by the Monitor in his December 10th affidavit where at paragraphs 29 and 30, he stated:

> It is common ground amongst all parties that any interest that BWR might have in and to the assets of BNC is subordinate to the interests of the Noteholders. The Noteholders have concurred in the proposed sale transaction and concurred in the sale of personal property.
>
> I am advised by counsel to the Noteholders and believe that the Noteholders will delegate or otherwise assign to me, in my capacity as Monitor, the full authority that the Noteholders hold under their security and, by virtue of the *Property Act* (New Brunswick), the authority to exercise such powers of sale or foreclosure powers as exists to fully extinguish any claim that BWR has in and to any of the BNC's assets. As such, BWR's pursuit of this purported right of first refusal is not only meritless but pointless.

60 It is well established that a mortgagee can only sell what interest is subject to the mortgage. Computershare can still proceed with the exercise of the power of sale under its security instrument, however the security is subject to the 20% property interest in the mine held by BWR. BWR is not arguing and has never taken the position that it was a secured creditor. BWR simply has asserted, certainly since December 9, 2009, that it is entitled to a 20% proprietary interest which they acquired when they converted their unsecured debenture to a 20% property interest holder. It cannot reasonably be argued on the whole of the evidence that BWR waived its proprietary rights by its actions and somehow abandoned its interest in the mine. Its 20% interest in the mine was the subject of litigation which was stayed by virtue of the CCAA, but never abandoned. That litigation has never been discontinued. I would also add that I do not agree with the position taken by PWC that BWR cannot be considered as having a property interest in the mine simply because it has not completed certain steps to the proposed transaction, namely to register its interest in the Registry Office or to comply with the *Mining Act*. It is also of interest to note that Blue Note required and obtained BWR's consent before entering into the agreement with Computershare.

61 On the face of the Note Indenture, it appears clear that Computershare in fact acknowledged that BWR had a right to exercise its conversion into a property interest which BWR did on August 29, 2008.

62 I conclude that Computershare cannot extinguish BWR's proprietary right by the exercise of its power of sale under the Property Act. Furthermore, Breakwater's interest is not subordinate to the Senior Secured Noteholders' interest as the Conversion Option was a permitted encumbrance under the note indenture.

63 In his Application, the Monitor is seeking that all rights, title and interest to the sale assets vest absolutely in the Purchaser free and clear from any interest, claims and encumbrances of any nature, including any interest of the Fern Trust as well as CanZinco Ltd. and Breakwater Resources Ltd. In fact, the monitor is seeking that the title in the property be cleared. Clearly the monitor cannot be in a better position than BNC and as such, any transaction is subject to any interest or rights which are found to exist in respect to the property.

64 In light of the findings made in these motions, the relief sought by the Applicant cannot be granted. I am not prepared to divest the Fern Trust and BWR of their interest in the Caribou Mine.

65 BWR at the hearing suggested that the Stay of Proceedings be permanently lifted as the stage II part of the Sale Agreement involves only the real property, the personal assets having been dealt with in the first stage and will remain unchallenged. BWR argues that there is no real reason to continue proceedings under the CCAA. On this issue, I agree with counsel for Computershare that the proceedings under the CCAA have been useful to date and on the whole, I am not prepared at this point to permanently lift the Stay of Proceedings. I am also unable to agree with counsel for some of the Lien Claimants' who was requesting that the Stay order be lifted so that the Lien Claimants' could continue with their action.

66 As to the Appeal on the disallowance of the Proof of Claim filed by BWR on January 8, 2010, pursuant to subsection 81(1) of the BIA, I believe that these reasons provides the answer to the Appeal filed by BWR.

Conclusion

67 In summary, I conclude that the NPI Agreement is not terminated and that paragraph f) in the NPI Agreement is not triggered by BNC's insolvency. I also conclude that BWR has a 20% proprietary right in the real property of the Caribou Mine. The record is insufficient to allow BWR's request that it be allowed to exercise its Right of First Refusal pursuant to the terms of the Joint Venture Agreement. Also, I find that the note indenture held by Computershare is subject to the proprietary interest of BWR. Finally, the request by BWR and some of the Lien Claimants' that the Stay of Proceedings order be lifted is denied.

68 As to the issue of costs, under the circumstances, each party will bear their own costs.

Order accordingly.

End of Document

4

2009 CarswellOnt 3614
Ontario Superior Court of Justice

1565397 Ontario Inc., Re

2009 CarswellOnt 3614, [2009] O.J. No. 2596, 178 A.C.W.S. (3d) 124, 54 C.B.R. (5th) 262, 81 R.P.R. (4th) 214

In the matter of the Receivership of 1565397 Ontario Inc., a company duly incorporated in Ontario with a head office in the Town of Maple, in the Province of Ontario

H.J. Wilton-Siegel J.

Heard: March 25, 2009; April 9, 2009
Judgment: June 23, 2009
Docket: 07-CL-7309

Counsel: Harvey G. Chaiton for A. Farber & Partners Inc., court-appointed Interim Receiver and Receiver and Manager of 1565397 Ontario Inc.
Brandon Jaffe for John Robert Learmonth
Michael W. Carlson for Marlucor Investments Inc.

Subject: Corporate and Commercial; Estates and Trusts; Property; Contracts; Public; **Insolvency**

Headnote

Debtors and creditors — Receivers — Conduct and liability of receiver — General conduct of receiver

Property was sold with term that when subdivision plan not approved, two portions of property would be held for respondents — Property mortgaged in manner which acknowledged condition — Receiver brought motion for sale of property without conditions — Motion dismissed — Terms of condition gave respondents **interest in land**, with rights deliverable at time of agreement — Nature of **interest in land** was similar to restrictive covenant, although rights existed in inchoate form only — Interest in property could be obtained without registration of subdivision plan — Specific performance not necessarily unavailable to force apportionment — Contracts were not executory in that parties had obligations that remained to be performed — Condition did not violate Planning Act — Section 50(3)(b) of Planning Act not violated, as prohibition in s. 50(3)(b) does not affect retention of interest unless interest confers right of disposal that is not dependent on third party — Respondents' inchoate interest was less than fee interest, and was not **interest in land** abutting property — Receiver did not have authority to disclaim or vest out interest — Court could not order sale as receiver did not have possession of rights to property — No assertion that there was no value in the property — **Interest in land** not derived from equity of owners and therefore subordinated to interests of mortgagees, and was not equitable charge which could be discharged on sale — Interests of respondents existed presently, independently of equitable charges — Mortgage did not extend to interest in relevant portions of property, interests in property had priority over mortgage and value of claim was not quantifiable on sale.

Estates and trusts — Trusts — General principles — Nature of trust

Property was sold with term that when subdivision plan not approved, two portions of property would be held for respondents — Property mortgaged in manner which acknowledged condition — Receiver brought motion for sale of property without conditions — Motion dismissed — No trust created in favour of respondents — Portions of property would be created at subdivision of property, constituting improper future trust — Terms of condition gave respondents **interest in land**, with rights deliverable at time of agreement.

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s. 50 — referred to

s. 50(3) — referred to

s. 50(3)(b) — considered

s. 50(21) — considered

Rules considered:

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R. 57.01(6) — referred to

MOTION by trustee for direction allowing sale of property free of condition.

***H.J. Wilton-Siegel J.*:**

1 The court-appointed receiver A. Farber & Partners Inc. (the "applicant" or the "receiver") of 1565397 Ontario Inc. ("156" or the "debtor") seeks the approval of the Court by way of advice and directions to disclaim an undertaking dated April 23, 2003 (the "Undertaking") given on the closing of the purchase of a property by the debtor. For the following reasons, the relief is denied.

Background

Circumstances of Delivery of the Undertaking

2 By an agreement of purchase and sale dated May 26, 2002 (the "Sale Agreement"), the respondent Marculor Investments Inc. ("Marculor") agreed to sell a 107 acre parcel of land located in West Gwillimbury (the "Property") to 2010149 Ontario Inc. ("201").

3 Schedule "A" to the Sale Agreement contained the following provisions:

2.(a) The aggregate purchase price for the Property, in the sum of One Million, Twenty-Five Thousand ($1,025,000.00) Dollars, as set out in this Agreement shall be paid or satisfied as follows: [...]

(b) The parties acknowledge and agree that the purchase price has been determined on the basis of the Property comprising 26 lots according to Draft Plan of Subdivision 43T-93015 (which lays out a total of 28 lots, it being agreed that Lots 14 and 16 on the said plan are not included in this transaction). ...

7. The Vendor covenants and agrees to deliver to the Purchaser on or before closing, the following:

(a) A transfer of the 26 lots comprising the Property in registerable form whereby title thereto in fee simple, subject to the exceptions herein provided, is conveyed to the Purchaser. In the event that the plan of subdivision of the Property is not registered by the closing date, the Purchaser shall hold Lots 14 and 16 on the Draft Plan of Subdivision in trust following closing and shall transfer Lot 14 to the Vendor and/or the Vendor's assigns, and shall transfer Lot 16 to Mr. Learmonth as prescribed in the Draft Plan of Subdivision 43T-93015, on demand without cost upon registration of the plan of subdivision.

4 At closing, the deed for the Property was delivered to 156 upon the direction of 201. Although it would appear that 201 and 156 were under common ownership, the parties have been unable to locate any formal assignment of the Sale Agreement to 156. Because Marculor did not register a plan of subdivision prior to the closing of the transaction, 156 delivered the Undertaking to the respondents at closing. I have proceeded on the basis that the rights of the respondents are derived from the Undertaking alone and that the respondents are not also alleging that the covenant in section 7(a) of the Sale Agreement is enforceable.

5 The Undertaking reads as follows:

IN CONSIDERATION of and notwithstanding the closing of the above transaction, the undersigned hereby undertakes as follows:

1. [...]

2. To hold Lots 14 and 16 on the Draft Plan of Subdivision in trust following the closing of this transaction and upon registration of the Plan of Subdivision undertakes to transfer Lot 14 to the Vendor and/or the Vendor's assigns and transfer Lot 16 to Mr. Learmonth as prescribed on the Draft Plan of Subdivision 43T-9315, on demand without cost in accordance with the Agreement of Purchase and Sale dated May 26, 2002, save and except for any Land Transfer Tax or any of the direct costs of the transferees.

6 Accordingly, pursuant to the Sale Agreement and the Undertaking, the respondent Marculor attempted to reserve Lot 14 for itself and Lot 16 for the respondent John Learmonth ("Learmonth"). Lot 14 is approximately 65 acres in area; Lot 16 is approximately 1.5 acres in area and includes Learmonth's residence.

Subsequent History of the Property

7 Pursuant to a commitment letter dated May 12, 2006, CareVest Capital Inc. ("CareVest") loaned approximately $3.4 million to 156 secured by a mortgage against the Property. CareVest had knowledge of the Undertaking prior to advancing any of these funds to 156. This is reflected in, among other things, letters dated July 29, 2008 to each of the respondents from CareVest's legal counsel in which the "prior interest" of the respondents in Lots 14 and 16 was recognized notwithstanding the fact that notices of the interests of the respondents pursuant to the Undertaking were not registered on title to the Property until 2008. For the reasons set out below, I think this statement should be understood to mean that the security constituted by the CareVest mortgage does not extend to the respondents' interests in the Property.

8 On December 7, 2007, the applicant was appointed by the Court as the receiver of 156 for the purpose of selling the Property by order of this Court (the "Receivership Order"). 156 had not registered a plan of subdivision by that date. The Receivership Order included powers in favour of the receiver to apply for registration of the draft plan of subdivision, to cease to perform any contracts of 156, and to apply for any **vesting** order necessary to convey the Property to a purchaser **free** and clear of any liens or **encumbrances** affecting the Property.

9 The applicant has satisfied all conditions to registration of the plan of subdivision, apart from entering into an agreement with a telecommunications supplier. The form of this latter agreement has been settled. However, the applicant does not intend to sign the agreement until after the Court has addressed the issue on this application. The applicant

does not otherwise foresee any other obstacle to registration of the plan of subdivision and intends to do so after this application is concluded.

Prior History of the Property

10 In 1989, Learmonth sold the Property to a predecessor in title to Marculor, Charlesmark Investment Corporation "(Charlesmark"), pursuant to an agreement dated April 14, 1989 (the "Charlesmark Sale Agreement"). None of the parties can locate a copy of the Charlesmark Agreement. However, Learmonth's solicitor registered notice of the Charlesmark Sale Agreement in the land registry office on April 27, 1989. This registration was removed from title, without notice to Learmonth, when the Property was put into the land titles system in 1999.

11 Charlesmark and Learmonth also entered into an agreement dated April 14, 1989, which contained the following provision (the "Charlesmark Undertaking"):

> Charlesmark Investment Corporation shall hereby undertake that upon the final approval of registration of the Plan of Subdivision for the proposed residential development of the Lands to convey to John Robert Learmonth, or his successors of [sic] assigns one (1) lot on the said plan of subdivision containing the existing one and one-half storey aluminium clad farm house and being approximately 1.5 acres in size at no cost to him.

I have proceeded on the basis that the Charlesmark Undertaking has been superceded by the Undertaking and therefore its continuing significance is limited to evidence of Marculor's knowledge of the interest of Learmonth in the Property.

12 Learmonth and Charlesmark also entered into a lease dated April 14, 1989 by which Learmonth leased the home and 1.5 acre parcel described in the Charlesmark Undertaking on a month-to-month tenancy at a rent of one dollar per month (the "Charlesmark Lease"). The Charlesmark Lease was stated to terminate upon the conveyance of the lot contemplated by the deed pursuant to which Learmonth transferred the Property to Charlesmark.

13 On October 1, 1993, Charlesmark transferred the Property to Marlucor. Marlucor does not deny knowledge of the Charlesmark Sale Agreement or the Charlesmark Lease.

Issues

14 The following issues are addressed on this motion:

1. does the Undertaking create a trust in favour of Marculor and Learmonth (collectively, the "respondents")?

2. does the Undertaking grant Marculor and Learmonth an **interest in land**?

3. does the applicant have the power to disclaim the Undertaking and/or sell the Property free of any interest of the respondents?

4. if the applicant has such power, do the equities favour granting approval to the applicant to disclaim the Undertaking and/or sell the Property free of any interest of the respondents?

Analysis and Conclusions

Does the Undertaking Create a Trust?

15 The respondents argue that the Sale Agreement, as supplemented by the Undertaking, created a trust of Lots 14 and 16 in favour of the respondents as of the date of closing of the sale of the Property. On this basis, they argue that the interests of the respondents in the Property did not vest in the applicant pursuant to the Receivership Order. I am not satisfied, however, that the Undertaking constituted, or evidenced, the creation of a trust in favour of the respondents as of its date of execution, whether in Lots 14 and 16 or otherwise.

16 Although courts will enforce a contract for the conveyance of future property by an order for specific performance, a trust of future property cannot be constituted. Lots 14 and 16 do not exist and will only come into existence, if ever, on the registration of the draft plan of subdivision. Accordingly, the Undertaking cannot constitute a trust of Lots 14 and 16 prior to registration of the draft plan of subdivision notwithstanding the language of the Undertaking which purports to establish a trust of Lots 14 and 16 at the time of its delivery. Instead, I think the proper interpretation of the Undertaking is that 156, as the settlor, has executed a binding declaration of trust in respect of a trust that is only effective as of the date it is "fed" by the coming into existence of Lots 14 and 16.

17 It is also questionable whether the inchoate property interests of the respondents described below are sufficiently certain as to subject matter to constitute a trust as of the date of execution of the Undertaking. In any event, however, the Undertaking does not evidence an intention to hold in trust an interest in the Property that is other than the fee in Lots 14 and 16.

18 For the same reason, it is not possible to construe the subject matter of the trust at the present time to be the covenant contained in the Undertaking insofar as it constitutes a declaration of an intention to create a trust. That obligation is expressed in the Undertaking by reference to holding in trust Lots 14 and 16, which do not yet exist, rather than to holding such interests in the Property as arise prior to registration of the draft plan of subdivision and thereafter holding in trust Lots 14 and 16. Therefore, the covenant in the Undertaking does not establish a trust at the present time.

19 Accordingly, I conclude that the Undertaking does not create a trust of the respondents' interests in the Property prior to registration of the draft plan of subdivision.

Does the Undertaking Create Interests in Land?

20 The following features of the Undertaking are relevant for this issue:

> 1. The Undertaking consists of a unilateral covenant on the part of 156 to hold Lots 14 and 16 in trust "following the closing of [the] transaction" together with a subsidiary covenant to convey the lots to the respondents upon their creation, which covenant would, in any event, be implied as a right of the beneficiaries of the trust;
>
> 2. While the Undertaking does not expressly say so, it is also clear that lots 14 and 16 are to be conveyed to the respondents free of any mortgage or lien incurred by 156;
>
> 3. The respondents are intended at all times to have interests only in respect of the portions of the Property that are to become Lots 14 and 16, rather than an undivided interest in the entire Property;
>
> 4. Insofar as the Undertaking can be construed as evidencing a contractual agreement between the parties respecting the transfer of Lots 14 and 16 to the respondents, the respondents have performed their obligations under such agreement by completing the sale of the Property; and
>
> 5. The Undertaking does not provide the respondents with any means of causing registration of the draft plan of subdivision. The conduct of the necessary work for such registration, and the timing of such registration, is left entirely in the discretion of 156.

Analysis and Conclusions

21 I conclude that the Undertaking creates interests of the respondents in Lots 14 and 16 that are properly characterized as **interests in land** on the following reasoning.

22 *Black's Law Dictionary*, 8th ed. (St. Paul, Minn: West Publishing Co., 2004) defines an inchoate interest as "a proprietary interest that has not yet vested." This appears to capture the nature of the rights granted the respondents under the Undertaking. The Undertaking is an unconditional obligation to vest Lots 14 and 16 in trust upon the

occurrence of a specified event. The fact that the lots have not yet been created does not prevent an interest in the Property arising prior to their creation as an "inchoate **interest**" **in land**. This conclusion is reinforced by the following considerations.

23 When considered collectively, the elements of the Undertaking described above indicate an intention to grant rights in the Property effective as of the date of delivery of the Undertaking rather than at a future date. The Undertaking purports, to the extent possible as of its date of delivery, to grant the respondents interests in two particular lots to be excluded from the Property in the future on registration of the draft plan of subdivision. There is no issue regarding the enforceability of the Undertaking as at the date of its delivery. The subject-matter of the Undertaking are rights specifically described by reference to that draft plan of subdivision. The Undertaking has effect unconditionally. Furthermore, the respondents have satisfied their obligations in respect of their interests in Lots 14 and 16 by completing the sale of the Property to 156. There are no further actions on their part required to obtain Lots 14 and 16 when they are created. Similarly, 156 has done all that is necessary to grant an interest in the Property upon the registration of the plan of subdivision by agreeing that it will hold Lots 14 and 16 in trust upon their creation without further action or condition.

24 The respondent's inchoate interests in the Property have a similarity to an **interest in land** created pursuant to a restrictive covenant. However, they differ from a restrictive covenant in that the interests exist in an inchoate form until such time as registration occurs at which time they mature to encompass the right to deal with Lots 14 and 16 as the beneficial owners thereof. However, the fact that the respondents do not have the full rights of beneficial owners as of the date of delivery of the Undertaking does not mean that the respondents did not acquire any interests in the Property when the Undertaking was delivered.

25 I think this conclusion is consistent with the authorities cited to the Court on this motion to the extent they address the issue. The applicant relies principally on four decisions: *New Skeena Forest Products Inc. v. Kitwanga Lumber Co.*, 2004 BCSC 1818 (B.C. S.C.), aff'd *New Skeena Forest Products Inc., Re*, 2005 BCCA 154 (B.C. C.A.); *Pope & Talbot Ltd., Re*, 2008 BCSC 1000 (B.C. S.C. [In Chambers]), *CareVest Capital Inc. v. CB Development 2000 Ltd.*, 2007 BCSC 1146 (B.C. S.C. [In Chambers]) and *bcIMC Construction Fund Corp. v. Chandler Homer Street Ventures Ltd.*, 2008 BCSC 897 (B.C. S.C. [In Chambers]). It argues that the respondents do not have any **interest in land** because the Undertaking is an executory contract and/or is a contract for the sale of the land for which a court will not grant specific performance. They rely upon the fact that the respondents cannot compel the applicant to register the plan of subdivision because the undertaking does not contain a covenant to register the draft plan of subdivision and that, in any event, a court will not compel a receiver to undertake further work, or to obtain financing, to complete a contract for the sale of land.

26 These are factually complicated decisions from which, in the case of the *bcIMC* and *CareVest* decisions, it is also difficult to extract the legal basis for the conclusions reached although in each case the practical result is compelling. However, I do not think these decisions are of any assistance in determining whether the respondents have an interest in the Property for four reasons: (1) the decisions do not actually address the issue in the terms suggested by the applicant; (2) there is no reason to conclude that specific performance - the unavailability of which was a significant factor in the decisions - is unavailable to the respondents in this case; (3) the issue of priority relative to secured lenders that is at the heart of the *CareVest* and *bcIMC* decisions does not arise in the present circumstances; and (4) the Undertaking differs from the applicable contracts in *CareVest* and *bcIMC* insofar as the latter are treated as executory. I will address each in turn.

27 First, as I read these decisions, they do not actually stand for the proposition proposed by the applicant — that a party cannot obtain an interest in a lot in an unregistered plan of subdivision until it is created by registration of the plan because a court will not grant specific performance to require completion of the remaining work required to bring the lot into existence.

28 In each of *New Skeena* and *Pope & Talbot*, Brenner C.J.S.C. held that the interests involved did not constitute an **interest in land** for reasons that are of no relevance to the issue in this proceeding. These decisions therefore do not address the issue in this proceeding.

29 In *CareVest*, Pitfield J. refused to exclude the possibility that the purchasers might have an "unregistered equitable charge against the project" ranking ahead of the second mortgage. His refusal to award specific performance was, therefore, not determinative of the issue of whether the purchasers had an **interest in land**.

30 In *bcIMC*, the court gave effect to the express contractual provisions in the purchase agreements that negated any **interest in land** arising thereunder. Such provisions are common in condominium purchase transactions and reflect at least a reasonable concern that a purchaser would have an **interest in land** absent such an agreement. In addition, apart from one sentence suggesting that the purchasers had no equitable interest in the projects because they were not yet registered, the court in *bcIMC* avoided the issue by holding, as the principal alternative conclusion, that if the purchasers had an equitable interest in the projects, the receiver had, or should be given, the power to disclaim the purchase contracts. This alternative conclusion was, in turn, based, not on the absence of any equitable interest in the projects, but rather on the absence of any equity in any interests in the property that the purchasers might have pursuant to the contracts. In the case of each of the disclaimed contracts, the purchasers were subordinated to the petitioner mortgagee and had no right of partial discharge of the petitioner's mortgage. In these circumstances, there was a basis for a "**vesting** out" order and no basis for an order for specific performance for the reasons expressed in *CareVest*. A **vesting** order in these circumstances is not inconsistent with the conclusion in this Endorsement for the reasons set out below.

31 In summary, therefore, insofar as *CareVest* and *bcIMC* address the issue of the existence of an **interest in land**, they do not decide the issue by reference to the availability of specific performance. Both these decisions treat the lack of availability of specific performance as a basis for authorizing a receiver to sell the relevant property free of equitable interests asserted by the purchasers rather than as determinative of the validity of the purchasers' claims. They do not proceed from a determination that specific performance is not available to a determination that the purchaser has no equitable interest. Instead, they proceed on the basis that the lack of availability of specific performance is a basis for ordering a sale of the relevant property free of a purchasers' claims even if the purchaser may be found to have an equitable interest.

32 Second, while it is axiomatic that a party can only have an equitable **interest in land** if a court is prepared to order equitable relief, I am not persuaded that the applicant is correct in its assertion that this principle can be applied to the present circumstances in the manner suggested by it.

33 I accept that, as in *CareVest* and *bcIMC*, specific performance will not be ordered where it amounts to a mandatory order that requires the incurring of borrowing obligations against the subject property and the completion of construction in order to bring the property into existence. However, these circumstances are not present in this proceeding.

34 The respondents are not bringing a motion for specific performance of the Undertaking as in *CareVest* and *bcIMC*. There is no need to do so. Instead, the receiver has, on its own volition, completed all the necessary work to register the draft plan of subdivision and intends to do so. It has undertaken this course of action based on its own assessment of the best means of maximizing the value of the Property, whether or not Lots 14 and 16 are included. In these circumstances, the issue of the availability of specific performance does not arise. The actions of the receiver in registering the draft plan of subdivision will trigger the Undertaking **vesting** Lots 14 and 16 in trust.

35 As a related matter, the applicant's decision to register the draft plan is a relevant consideration in assessing the equities relative to the receiver's exercise of any right it might have to "vest out" the respondents' rights. This is addressed below.

36 The applicant says that the Court should disregard the fact that it has chosen to undertake this work and consider the issue of the respondents' interests in the Property as of the date of the appointment of the applicant as the receiver of 156. I think this merely begs the question. The issue of whether the respondents had an interest in the Property would only have been presented at that time if the receiver had proposed selling the Property. This would have required the respondents to bring a motion for specific performance. If, however, it had proposed at that time to register the draft plan

of subdivision, I do not see how the circumstances would have been any different from those presented today. In short, as long as 156 or the applicant was, or is, proposing to register the draft plan of subdivision, the respondents do not need the Court's assistance by way of an order for specific performance to enforce their interests in the Property. Moreover, specific performance will be available upon registration of the draft plan of subdivision, whenever that occurs, to enforce the trust contemplated by the Undertaking. In these circumstances, I think it is unnecessary for the Court to consider the availability of specific performance in the determination of whether the respondents have interests in the Property.

37 Third, the interests in the Property asserted by the respondents are fundamentally different from the **interests in land** addressed in *CareVest* and *bcIMC* upon which the applicant relies, except in one respect addressed below that contradicts the applicant's position.

38 In each case, the court was prepared to consider the possibility that the purchasers had an equitable interest in the properties. However, it was also clear that, in each case, further construction activity was required in order to realize any value in the property which, in turn, required considerable additional financing secured against the entire project including the purchasers' units. The purchasers, therefore, had no equity in their proposed condominium units unless they ranked in priority to the existing mortgage financing on the projects. The court was prepared to consider that possibility in *CareVest*, resulting in an order for sale with a subsequent hearing on the priority issue. It did not consider that to be a possibility in *bcIMC*, resulting in an order for sale based on the absence of any equity of the purchasers in the property.

39 In the present circumstances, however, the Undertaking provides that the interests of the respondents are carved out of the interest of 156 and are entirely separate. The Sale Agreement expressly provides that the transaction did not include Lots 14 and 16 and that Lots 14 and 16 are not part of the Property to be retained by 156. Accordingly, as mentioned, the Undertaking must be taken to provide that 156 was obligated to discharge any mortgage financing on the Property upon **vesting** of Lots 14 and 16 in trust. There is no suggestion in the record that either of the mortgagees (including CareVest) understood the Undertaking to operate differently vis-à-vis 156. There is, therefore, no priority issue to be determined regarding the respondents' interests in the Property. Nor is there any dispute that there is substantial equity in the respondents' interests in the Property.

40 Fourth, while it is not express, I agree with the applicant that an important consideration in *bcIMC* and *CareVest* is the fact that the contracts are executory in the sense that each party had obligations that remained to be performed. I would add that it was also the case that, even if the purchasers had performed their obligations under their respective contracts to pay the remaining purchase price, their performance would have been insufficient to fund the construction necessary to bring the condominium units into existence.

41 By contrast, in the present proceeding, the contract was not executory in that sense. Neither Marculor nor Learmonth was required to perform any further obligations to obtain their interests in Lots 14 and 16. This element is a relevant equitable consideration that is addressed below. However, I also think it distinguishes the cases relied upon by the applicant from the present circumstances and reinforces the conclusion that the respondents acquired interests in the Property pursuant to the Undertaking.

42 In summary, therefore, the principles in these decisions do not prevent the Undertaking from creating **interests in land** in favour of the respondents and, in certain respects, support that conclusion.

*Is the **Interest in Land** Void Under the Planning Act?*

43 The applicant argues that, if the Undertaking creates **interests in land**, such interests are void under clause 50(3)(b) of the *Planning Act*, R.S.O. 1990, c. P.13 (the "Act") and are not saved by subsection 50(21) of that Act. These provisions read as follows:

> (3) No person shall convey land by way of a deed or transfer, or grant, assign or exercise a power of appointment with respect to land, or mortgage or charge land, or enter into an agreement of sale and purchase of land or enter

> into any agreement that has the effect of granting the use of or right in land directly or by entitlement to renewal for a period of twenty-one years or more unless,
>
> . . . . .
>
> (b) the grantor by deed or transfer, the person granting, assigning or exercising a power of appointment, the mortgagor or chargor, the vendor under an agreement of purchase and sale or the grantor of a use of or right in land, as the case may be, does not retain the fee or the equity of redemption in, or a power or right to grant, assign or exercise a power of appointment in respect of, any land abutting the land that is being conveyed or otherwise dealt with other than land that is the whole of one or more lots or blocks within one or more registered plans of subdivision; ...
>
> (21) An agreement, conveyance, mortgage or charge made, or a power of appointment granted, assigned or exercised in contravention of this section or a predecessor thereof does not create or convey any **interest in land**, but this section does not affect an agreement entered into subject to the express condition contained therein that such agreement is to be effective only if the provisions of this section are complied with.

44 Conversely, the respondents submit that the Undertaking does not violate the Act for two reasons: (1) the **interests in land** conferred thereby are not prohibited by paragraph 50(3)(b); and (2) in any event, any defect under section 50(3) is remedied by section 50(21). I will address each in turn.

Application of Paragraph 50(3)(b)

45 The applicant says that the Undertaking constitutes an option to purchase land that violates the *Planning Act*. Given the nature of the respondents' interest in Lots 14 and 16, I do not think it is accurate to characterize their interest as an option to purchase. However, whatever the characterization, the case law makes it clear that the prohibition in clause 50(3)(b) does not affect the retention of an **interest in land** unless that interest confers a right of disposal of the land that is not dependent on the action or inaction of a third party: see *Redmond v. Rothschild*, [1971] 1 O.R. 436 (Ont. C.A.) at 441; *Pattison v. Sceviour* (1983), 43 O.R. (2d) 229 (Ont. H.C.); and *Ratnanather v. Kosalka* (1995), 24 O.R. (3d) 326 (Ont. Gen. Div.)).

46 The applicant relies on the decision in *Morgan Trust Co. of Canada v. Falloncrest Financial Corp.* (2006), 218 O.A.C. 71 (Ont. C.A.) in which the Court of Appeal held that an option to purchase land violated section 50(3) of the Act. However, in that case, the option could be exercised on the earlier to occur of three events, one of which was the mere expiration of 20 years from the date of the option agreement. Such an option is in clear violation of the Act because the optionee retained an **interest in land** that could be conveyed, at the latest, at the end of the 20-year period.

47 In the present circumstances, while the respondents do retain inchoate interests in the Property that are assignable, such interests do not constitute a "fee" in Lots 14 or 16. Until registration of the draft plan of subdivision, the "inchoate" interests of the respondents constitute a lesser **interest in land** for purposes of section 50(3). Nor do such interests constitute an **interest in land** abutting the Property. Such a relationship can only arise at the time of creation of Lots 14 and 16. Similarly, the respondents do not have the power to mortgage or dispose of Lots 14 and 16 prior to registration of the draft plan of subdivision. The Undertaking does not permit the respondents to convey Lots 14 and 16 at any time prior to registration. Until that time, the respondents can convey no more than the inchoate interests in such lots described above. Nor, as mentioned, is there a positive obligation on 156 to register the plan of subdivision or any right in favour of the respondents to cause such registration. Therefore, until registration occurs as a result of a decision by 156, which might never happen, the respondents also cannot be said to have retained a "power or right to grant, assign or exercise a power of appointment" in respect of Lots 14 and 16.

48 The circumstances in the present proceeding are indistinguishable from those in *Marcrob Estates Ltd. v. Servedio* (1977), 1 R.P.R. 344 (Ont. C.A.), at 345, aff'd, in which Cromarty J. concluded that the predecessor of subsection 50(3)(b) was not invoked on the following basis:

> There is no evidence that Marcrob was the owner of any lands abutting those conveyed to Rosa and Vincenzo Crocitto. If it is the defendants' argument that by putting an option to purchase into the agreement of sale, he was attempting to retain the fee in the "back lands" it appears to me that it conveyed all of its lands subject only to the right to purchase a portion of them if and when the Planning Act was complied with in accordance with the terms of the agreement.

49 A similar decision was reached in *Ratnanather v. Kosalka* (1995), 24 O.R. (3d) 326 (Ont. Gen. Div.), which applied *Marcrob* and which addressed the application of the predecessor to subsection 50(3)(b) to a transfer of an entire parcel of land under a plan of subdivision for the value of part of the parcel coupled with an option to buy back the unpaid part of the parcel within a fixed period of time. In that case, Langdon J. concluded:

> To retain an "interest" in part of the land is not necessarily to retain the fee or the power of disposition. ... *Miller v. Ameri-cana Motel Ltd.*, [1983] 1 S.C.R. 229, 143 D.L.R. (3d) 1, held that the granting of an option vests in the option-holder an equitable interest in the optioned lands. This means that the disposing power is no longer held by the grantor of the option. But does this mean that the opposite is true, i.e., that the power to dispose has been transferred to the option-holder to such an extent that he has the "fee"? The option-holder's interest is assignable. However, before he exercises the option and acquires full legal title he cannot dispose of or mortgage the optioned part. The option-holder has an equitable interest but cannot be said to have the power to dispose of the land. He can block disposal by the title-holder for the life of the option (or 21 years) but, absent approval under the Planning Act, cannot himself dispose of the property. With Planning Act approval, his power to dispose offends no policy.
>
> The definition of "fee" for the purposes of the Planning Act has evolved with a view to a functional, rather than a technical approach, to the Act and to the regulation of specific land transfers: see Sidney Troister, The Law of Subdivision Control in Ontario, 2nd ed. (1994). A functional approach examines whether the purposes of the Act have been frustrated by the transaction.
>
> While this transaction was structured to avoid the Planning Act restrictions on the retention of abutting land, it did so by compliance, i.e., by a transfer of the whole. The risk of getting back less than the whole was borne by the contracting party. The Act does not forbid risk-taking. The purpose of the Act is to prevent the subdivision of land without planning approval. No parcel of land was subdivided. The sellers retained an interest in part of the parcel but not one equal to a power to dispose. The option and its exercise would never create more than one parcel if approval were not forthcoming. I conclude that the seller did not retain the fee in abutting lands within the meaning of the Planning Act. This conclusion accords with the result of the decision of the Court of Appeal in Marcrob.

50 I am of the opinion that these principles are equally applicable in the present circumstances.

Application of Section 50(21)

51 Given the foregoing conclusion, it is unnecessary to consider the further issue of whether, if the Undertaking were characterized as an **interest in land** to which section 50(3) applied (whether as an option to purchase or otherwise), 50(21) operates to remedy any defect under section 50(3) given the particular terms of the Undertaking. I am of the opinion, however, that it does so in the unique circumstances of this proceeding on the following reasoning.

52 At all times, the parties expressly envisaged compliance with the Act in the form of registration of the draft plan of subdivision as a condition of 156's obligation to hold Lots 14 and 16 in trust of the respondents. The Undertaking therefore provides that Lots 14 and 16 will only vest in trust in favour of the respondents in circumstances in which the Act will necessarily have been complied with. Such an **interest in land** satisfies the objective of the Act of preventing subdivision of land without planning approval. Moreover, the terms of the Undertaking comply substantively with the provisions of section 50(21) if the provision is interpreted to require a conditionality to the arrangements that has the result that the Undertaking is only effective to vest Lots 14 and 16 in trust upon actions of 156 that include compliance with the Act. I am of the opinion that these circumstances are sufficient to satisfy the saving clause in section 50(21).

53 Such an interpretation is consistent with other decisions on this issue. In particular, in *Ratnanather*, Langdon J. addressed a provision that apparently stated simply that the option to purchase was "subject to severance".

> I find no merit whatever in the Kosalkas' argument that the wording of this second option was somehow insufficient to fulfil the requirements of s. 50(21) of the Planning Act in that it did not constitute "an express condition contained therein that such agreement is to be effective only if the provisions of this section are complied with". The purpose of s-s. (21) is to validate and facilitate agreements which otherwise would be made ineffective by the language of the infamous s. 50(3)(b). No precise formula of words is needed to invoke s-s. (21). The expression "severance" meaning a subdivision of a parcel of land authorized under the Planning Act is so common and pervasive in the real estate industry in Ontario as to need no further explanation. The requirements of s-s. (21) would be fulfilled if nothing more had appeared in the agreement than "subject to (a) severance".

54 The applicant relies on the statement of LaForme J.A. in *Morgan Trust* at para. 20, which could be read to provide that, absent inclusion of explicit reference to compliance with s. 50 in the relevant agreement, no reservation of a right of disposition will be saved by section 50(21). However, as mentioned, the option to purchase in *Morgan Trust* could not be saved under section 50(21) as it did not, by its terms, restrict the exercise of the option to purchase to circumstances in which the Act would necessarily have been complied with. As such, it does not address the specific issue raised in this case. Nor did the relevant agreements in any of the other decisions relied upon by LaForme J.A. in reaching his conclusion: see *Dical Investments Ltd. v. Morrison* (1990), 75 O.R. (2d) 417 (Ont. C.A.), at 425; *Nepean Carleton Developments Ltd. v. Hope* (1976), [1978] 1 S.C.R. 427 (S.C.C.); and *Murray Elias Ltd. v. Walsam Investments Ltd.*, [1964] 2 O.R. 381 (Ont. H.C.), aff'd [1965] 2 O.R. 672n (Ont. C.A.).

55 The principle articulated in each of *Nepean, Dical Investments* and *Morgan Trust* is that an implied covenant to make an agreement for the sale of land effective on compliance with the *Planning Act* does not satisfy the requirement in section 50(21) for an express condition. Accepting that this principle remains the law in Ontario, I do not think that it can properly be applied in the present circumstances for the reason that there is no such agreement, as such, to be complied with. Instead, there is a commitment to vest Lots 14 and 16 only upon the occurrence of an event - registration of the draft plan of subdivision - which constitutes compliance with the *Planning Act*. In the present circumstances, inclusion in the Undertaking of a term of the nature contemplated in *Nepean, Dical Investments* and *Morgan Trust* that the **vesting** in trust of Lots 14 and 16 is only to be effective upon compliance with the *Planning Act* would be unnecessary and any such term would clearly be redundant - the trust can only exist if there has been such compliance.

56 Accordingly, if it were held that the respondents' interests in the Property were caught by section 50(3), I conclude that they remained enforceable interests in the Property by virtue of section 50(21).

Conclusion

57 Based on the foregoing, I conclude that the respondents have enforceable interests in the Property pursuant to the Undertaking.

Authority of the Receiver to Disclaim and/or Obtain a Vesting Order in Respect of the Respondents' Interest in the Property

58 The applicant argues that, even if the respondents have a property interest in the Property pursuant to the Undertaking, the receiver may disclaim the Undertaking and sell the Property free and clear of the respondents' interests. I propose to discuss three elements of this position.

Can the Receiver Disclaim the Undertaking?

59 The applicant says that it can disclaim the Undertaking even if it creates an **interest in land**. I understand disclaimer in this sense to be limited to repudiation of the Undertaking leaving the respondents with a right to claim damages for breach of contract against 156 for failure to perform the Undertaking.

60 I do not think the applicant's position is correct. I know of no law that permits a court to authorize a receiver to terminate a proprietary interest in land in such manner. The effect of any such extinguishment of an interest in the Property would be the transfer of such interest to 156. Such action amounts to expropriation of the respondents' assets in favour of subordinate or unsecured creditors of 156.

61 In addition, as a related matter, insofar as the Undertaking can be construed as an agreement for the sale of land as the applicant suggests, it has been fully performed by the respondents. Any breach, or more properly anticipatory breach by the applicant, at this time, cannot convert an interest in land into an unsecured claim.

62 Moreover, the case law cited to the Court by the applicant does not support such a right. As mentioned above, the decisions in *New Skeena* and *Pope & Talbot* are not relevant as, in each case, the court held that the relevant parties did not hold an interest in land. In *CareVest*, Pitfield J. proceeded on the basis that it was possible that the strata contract purchasers had an equitable interest in the property and expressly dismissed the receiver's application for the power to disclaim the relevant contracts. In *bcIMC*, the court proceeded on the alternative grounds that (1) the purchasers had no interest in land; and (2) that, if the purchasers had an interest in land, it could be "vested out" based on the absence of any equity in such interest, rather than that the contract could be disclaimed.

Can the Receiver "Vest Out" the Undertaking?

63 The applicant also argues that the receiver is entitled to "vest out" the interests of the respondents in the Property, by which it means selling the Property free of the interests of the respondents in the Property pursuant to the Undertaking. The applicant makes two alternative submissions regarding a receiver's power to "vest out" a proprietary interest.

64 The more aggressive position of the receiver is that the Court can authorize the receiver to sell free of the respondents' interests in the Property leaving the respondents with an unsecured claim for damages against the Receiver. This is no different from the concept of disclaimer addressed above. For the reasons stated above, I do not accept that the Court or the receiver has such power in respect of an interest in land except perhaps in circumstances in which it is clear that there is no equity in the interest being "vested out".

65 The less aggressive position is that the Court has the authority to authorize the receiver to sell the Property free of the respondents' interests with a subsequent hearing to be held to determine the value of the respondents' interests. It finds support for such right in the *CareVest* and *bcIMC* decisions. The remainder of this section addresses the authority of the Court to authorize the receiver to "vest out" the respondents' interests in the Property in this sense.

66 I would note first that there is a significant difference between the present circumstances and the circumstances in the decisions upon which the applicant relies. The applicant is seeking authority to sell the interests in the Property of both the debtor, in this case 156, and the respondents. It contemplates a subsequent hearing to determine the allocation of the purchase price between the two interests, it being acknowledged that the interests of the respondents have real value. In *CareVest* and *bcIMC*, the receiver sought authority to sell a property free and clear of an equitable right in such property asserted by a third party. The purpose of the subsequent hearing ordered in *CareVest*, and considered in *bcIMC*, was to determine whether such equitable right existed rather than to determine the value of such right, which was either quantified or quantifiable on the sale of the property.

67 Whether or not the Court has the authority alleged by the applicant generally, I do not think the Court has the authority to order a sale of the respondents' interests in the Property on the basis proposed by the applicant for the following four reasons.

68 First, it follows from the conclusion that the Undertaking created property interests in the Property in favour of the respondents, that 156 granted, and therefore no longer retained, such interests. Such interests in the Property reside in the respondents whose property is not subject to the receivership. In this respect, the present circumstances are similar to those in *Terastar Realty Corp., Re* (2005), 16 C.B.R. (5th) 111 (Ont. S.C.J.) and analagous to those in *2022177 Ontario*

Inc. v. Toronto Hanna Properties Ltd. (2005), 203 O.A.C. 220 (Ont. C.A.) (in which, however, density rights were found not to be proprietary rights). As the receiver of 156, the applicant has taken possession of the property of the debtor only. It cannot have taken possession of, or otherwise have any interest in, the respondents' interests in the Property, regardless of the terms of the Receivership Order because the Order extends only to the assets of 156. As such, the applicant has no authority under the Receivership Order to sell the interests of the respondents. Nor does the Court have the authority to grant such an order in the absence of the appointment of a receiver over the respondents' property and assets.

69 Second, this is not a circumstance in which the receiver is seeking approval to sell a mortgagor's equity of redemption on the basis that either there is no equity in the property or that the mortgagor has no ability to service the mortgage. There is no suggestion that the respondents have any obligation to CareVest in respect of the CareVest mortgage. In addition, as mentioned, because the respondents' interests in the Property are separate from the interest of 156 and given the terms of the Undertaking, there is no question that there is value in the interests of the respondents.

70 Third, as mentioned, the present circumstances differ from those in *bcIMC* and *CareVest* in that the issue is not a priorities dispute between creditors in respect of a quantified, or quantifiable, claim. In these decisions, the court treated the purchasers' interests in the relevant projects as derived from the equity of the project owners and therefore as subordinated to the interests of the mortgagees (subject to the priority issue raised in *CareVest* which is irrelevant for the present proceeding). In addition, the court treated the claims of the purchasers as an equitable charge that could be discharged on sale of the relevant property pursuant to an express or implied power of sale.

71 It is not possible to treat the respondents' interests in the Property in this manner for four reasons. First, for the reasons stated above, the interests of the respondents exist as of the present time otherwise than by way of an equitable charge against the property of 156 derived from the equity of redemption of 156. Second, it is questionable whether the CareVest mortgage extends to such interests given the intention that Lots 14 and 16 are intended to be conveyed to the respondents upon their creation free of any mortgages or liens incurred by 156. Third, even if it does, CareVest has acknowledged that the respondents' interests in the Property rank in priority to its mortgage. Lastly, the value of the respondents' claims are neither quantified nor quantifiable upon a sale of the Property.

72 Finally, as a related matter, the absence of any principle or basis for allocating the proceeds of sale of the Property between the interest of 156 and the interests of the respondents reflects the conceptual defect in the applicant's position. Even prior to registration of the draft plan of subdivision, the interests of the respondents in Lots 14 and 16 are entirely separate and distinct from the interest of 156 in the Property.

73 In reaching the conclusion that the receiver does not have the power to "vest out" the respondents' interests in the Property, I have also concluded, for the reasons set out below, that the four decisions cited above do not support the applicant's position that the Court has the authority to order such a sale.

74 As mentioned, the decisions of Brenner C.J.S.C. in *New Skeena* and *Pope & Talbot* proceed on the basis that there was no *in rem* or proprietary **interest in land** involved so the issue did not arise. In fact, the approach of Brenner C.J.S.C. in these decisions implies that he would have reached a contrary result in each case if he had found that the applicants held an *in rem* or proprietary right, which reinforces the conclusion that a court does not have the authority to authorize a "**vesting** out" of an **interest in land**. I do not read the appellate decision in *New Skeena* as proceeding on a different basis because the British Columbia Court of Appeal upheld this determination of Brenner C.J.S.C. before concluding that the **vesting** order language in the receivership order was sufficient authority in favour of the receiver to allow it to disclaim the relevant contracts. I would add that I do not think that **vesting** language in a receivership order can, by itself, be determinative. It depends for its effectiveness upon the authority of the court to approve "**vesting** out" transactions in any particular circumstance.

75 In *bcIMC*, the principal basis of the decision is that the strata contract purchasers did not have an **interest in land** by virtue of express contractual provisions. The alternative conclusion that the receiver should be given the power to sell the projects free of the purchasers' equitable interests under their purchase contracts was based on the absence of any

equity in such equitable interests because partial discharges of the relevant lots were not available. While the court also referred to other specific equitable considerations in considering each of the contracts individually, this is the common thread that runs through the decision in respect of each of the purchase contracts. While the Court has the authority to order such a "vesting out" of property interests having no residual equity in order to permit a sale of property subject to security (or, as in *CareVest*, a refinancing of such a property), as mentioned above, these circumstances are not present in this proceeding.

76 Insofar as *CareVest* may suggest that the purchasers had an interest in land that could be "vested out", it is clear that the Court did not address the contractual provisions in the strata purchase contracts and did not make an express finding that the purchasers had an interest in land. There are also two features of the property interest asserted by the purchasers in the *CareVest* decision that are not present in this proceeding that have been mentioned above. First, the court treated the purchasers' potential interest as an equitable charge to secure the excess of the sale price over the contract price. Second, as a related matter, the court proceeded on the basis that a sale of the Property was warranted because there was no remaining equity in the project. In the present circumstances, the interests of the respondents in the Property are separate and distinct from the interest of 156, rather than derived from 156's equity in the Property in the manner of the strata purchase contracts in *CareVest* and *bcIMC*, and have real value.

77 For these reasons, I also do not find any of the decisions cited by the applicant to be of any assistance on the authority of the receiver to sell the Property free and clear of the interests of the respondents.

Do the Equities Favour a Disclaiming of the Undertaking and/or Vesting Out of the Property Free of Claims Under the Undertaking?

78 If I have erred in concluding that the Court does not have the power to authorize the receiver to disclaim the Undertaking and "vest out" the respondents' interests in the Property granted pursuant to the Undertaking, the receiver is nevertheless subject to the requirement that it must exercise proper discretion in making a decision to do so. As an officer of the Court, it must have regard to equitable considerations.

79 In my view, the equitable considerations in this case argue against permitting a receiver to sell the Property free of the respondents' interests in the Property pursuant to the Undertaking. Accordingly, to the extent that the issue in these proceedings turns on whether the Court should exercise its discretion, I would decline to make such an order having regard to the five equitable considerations set out below.

80 First, the respondents have valuable interests in property, rather than a mere contractual interest that can be terminated in respect of future obligations. As mentioned, the effect of the requested relief would be to transfer the value of the respondents' interests in the Property to 156 for no compensation.

81 Second, as a related matter and as mentioned above, the respondents have fully performed the obligations that were the pre-condition to the creation of their rights, and given consideration for the Undertaking, by closing the transaction contemplated by the Sale Agreement. This is not an instance of termination of an executory contract in the sense of a contract in which both parties have obligations under the contract that remain to be performed.

82 Third, unlike the circumstances in *Morgan Trust*, there is no issue of notice of the Undertaking and, therefore, no issue of unjust enrichment. Each of 156 and CareVest has been aware of the Undertaking from the time of their initial involvement with the Property. In particular, CareVest had knowledge of the Undertaking when it made its loans to 156. It therefore knew that compliance with the Undertaking was a cost of any realization proceedings if it concluded that registration of the draft plan of subdivision prior to the sale of the Property would increase its recovery.

83 Fourth, the fact that there is no goodwill of 156 to preserve is not, by itself, an equitable consideration in favour of "vesting out" the Undertaking given the nature of the respondents' interests in the Property. Similarly, the fact that the receiver will receive no proceeds of sale from Lots 14 and 16 is not a valid consideration given the intention of the

parties as set out in the Undertaking and the absence of any further covenant to be performed by the respondents to obtain the benefit of the Undertaking.

84 Fifth, as mentioned, the applicant intends to register the draft plan of subdivision. There is no question that the intention of the parties was that Lots 14 and 16 were not to be included in the Property ultimately retained by 156 after such registration. Similarly, there is no question that the intention of the parties was that 156 was to convey Lots 14 and 16 to the respondents free of any mortgage or lien securing any obligations of 156, including any financing required to fund the costs of registration of the draft plan of subdivision. There is no basis in the record for a conclusion that either of such features of the Undertaking were to terminate in the event of the **insolvency** of 156.

85 More generally, the applicant is, in effect, seeking to have it both ways. It has chosen to complete the action triggoring the Undertaking but claims an entitlement to disclaim its obligation to do so. In the present circumstances, in which the receiver intends to register the plan of subdivision, the remedy of specific performance would, therefore, absent special circumstances, be available to the respondents if the receiver does not also honour the Undertaking. The receiver can only seek the power to disclaim the Undertaking in such circumstances if it can demonstrate that the respondents' interests in the Property have no value. It cannot do so.

Conclusion

86 Based on the foregoing, the applicant's requested declaration that it is entitled to disclaim the Undertaking and sell the Property free of the interests of the respondents therein pursuant to the Undertaking is denied.

87 The parties are at liberty to schedule a hearing on the remainder of the application at a 9:30 a.m. conference to be scheduled by counsel.

Costs

88 The parties shall have 30 days from the date of these reasons to make written submissions with respect to the disposition of costs in this matter, and a further 15 days from the date of receipt of the other party's submission to provide the Court with any reply submission they may choose to make. Submissions seeking costs shall include the costs outline required by Rule 57.01(6) of the *Rules of Civil Procedure*, R.R.O. 1990, Reg. 194, as amended. To the extent not reflected in the costs outline, such submissions shall also identify all lawyers on the matter, their respective years of call, and rates actually charged to the client, with supporting documentation as to both time and disbursements.

Motion dismissed.

End of Document

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2012 ONSC 2768
Ontario Superior Court of Justice

Royal On Gordon Retirement Residence Inc. v. Paterson

2012 CarswellOnt 9725, 2012 ONSC 2768, 20 R.P.R. (5th) 339, 222 A.C.W.S. (3d) 815

Royal on Gordon Retirement Residence Inc., Applicant and Albert Edward Paterson and Mary Edith Paterson, Respondents

Langdon J.

Heard: May 1, 2012
Judgment: May 8, 2012
Docket: Guelph 161/12

Counsel: J. Melia, for the Applicant
C. Davis, for the Respondents

Subject: Property; Contracts; Public

Headnote

Real property --- Easements — Registration and notice — Under Land Titles Acts

Applicant and respondents owned abutting lands that had access to street by means of service road — Applicant proposed to alter means of access to street by way of easement on its own land (proposed easement) — Proposed easement had to be annexed to respondents' land, which was dominant tenement — Applicant obtained approval for proposed easement under Planning Act — Respondents refused to authorize registration of deed creating proposed easement, which authorization was necessary in order to register deed under Land Titles Act — Applicant brought application for order vesting proposed easement in respondents' land under s. 100 of Courts of Justice Act (CJA) — Application dismissed — Court had no jurisdiction to make order sought — Section 100 of CJA does not provide stand-alone jurisdiction to grant relief, but only provides mechanism to vest title to property in respect of which there is separate, valid claim to ownership — Applicant had no claim to ownership or possession of respondents' land — Absent such right of ownership, court had no freestanding right to vest any interest in respondents' land.

Table of Authorities

Cases considered by *Langdon J.*:

Trick v. Trick (2006), 271 D.L.R. (4th) 700, 2006 CarswellOnt 4139, 213 O.A.C. 105, 54 C.C.P.B. 242, 31 R.F.L. (6th) 237, 81 O.R. (3d) 241, 83 O.R. (3d) 55 (Ont. C.A.) — followed

Statutes considered:

Courts of Justice Act, R.S.O. 1990, c. C.43
s. 100 — considered

Land Titles Act, R.S.O. 1990, c. L.5
Generally — referred to

Planning Act, R.S.O. 1990, c. P.13
Generally — referred to

APPLICATION by owner of land for order vesting proposed easement in abutting land under s. 100 of *Courts of Justice Act*.

Langdon J.:

1 The parties own abutting lands that have access by means of a kind of service road to Gordon Street in the City of Guelph. The juxtaposition of the parcels can be seen in the application record at Tab F.

2 The applicant operates retirement residences on its larger parcel of land, municipally known as 1671 - 91 Gordon Street. In the fall of 2010, it made application to the City of Guelph in connection with a planned expansion. Guelph and Royal entered into a site plan agreement to facilitate it. Paragraph 4 of this agreement reveals the City's intention, at some future date, to alter the means by which both parties' properties will gain access to Gordon Street. Paragraph 5 of the agreement obliges Royal to construct an access road that will enable the property owners, including the respondents, to have a different connection/right of way to Gordon Street as it will be after it is reconstructed.

3 The right-of-way that Royal must dedicate is located entirely on Royal's property. However, in order to create a valid easement, it, as the servient tenement, must be annexed to a dominant tenement by deed. The respondents' premises are that dominant tenement. If the deed is registered, the respondents and their successors in title will enjoy the right to use the easement to gain access to Gordon Street as it will be after it has been reconstructed. The creation of the easement places no burden on respondents' lands or title. It merely confers an additional right to pass over the right-of-way, a right that respondents are not obliged to exercise.

4 If the registration of the easement is not perfected on time, the Committee of Adjustment's consent will expire and, at a minimum, the whole application process will have to be repeated. But the failure to register the easement places Royal in breach of paragraph 5 of the site plan agreement with the City.

5 The *Planning Act* of Ontario requires that the creation of an easement be approved by the Committee of Adjustment. Royal initiated an application for permission to create the easement. Although the respondents do not admit that they were notified of the application, the material filed satisfies me that the respondents received all appropriate notices of the hearing, the decision and of the relevant appeal periods. The respondents took no part whatsoever in the Committee of Adjustment process. The Committee approved the creation of the easement. The appeal period has expired.

6 The Committee's decision is time limited in effect. The effect of this deadline is that the deed creating the easement must be registered on title within 2 years of the Committee's decision, or by November 30, 2012.

7 In order for the deed to be registered, the *Land Titles Act* requires that any landowner whose land is affected by the deed must authorize registration by signing an acknowledgement and direction. Such a document was prepared by Royal's solicitors and sent to the respondents. Indeed, because of a corporate name change, two such documents were sent to the respondents. The more recent was in November 2010. Respondents have not responded in any way to the request by Royal to execute the authorization and direction.

8 Royal applied to the City to waive the requirement for registration of the easement but the City demurred. Royal is thus between a rock and a hard place. They must get the deed registered or be in breach of the site plan agreement and perhaps imperil their expansion.

9 Royal has applied for an order under s. 100 of the *Courts of Justice Act* which provides:

> A court may by order vest in any person an interest in real or personal property that the court has authority to order be disposed of, encumbered or conveyed.

10 Respondents purchased their lands in 1958. Since then they have occupied them as their residence. They acknowledge that many nearby properties have been developed for commercial use. Royal is their neighbour on the south and their neighbouring property on the north, formerly a residence, has been bought for use as a medical clinic. The dwelling house now stands vacant. Respondents declined an offer from the medical clinic developers to buy their lands.

11 Respondents are quite content with the status quo. They disapprove of the City's plan eventually to alter their means of access to Gordon Street. They say the redeveloped street will significantly reduce their frontage. They simply want to be left alone to live in their residence, as they have for some 54 years.

12 Respondents have some issues with Royal. They complain that Royal changed some elevations that blocked them from making a sewer connection with City sewers and interferes with storm water disposal. They claim that Royal did not adhere to its storm water disposal drawings and that excess storm water now accumulates on their lands and may affect their septic system. They claim that the easement/sub road that has been physically constructed by Royal is causing harm to trees on respondents' premises. They claim that Royal has constructed a fence on respondents' lands and that the fence is unfinished.

13 Respondents have decided not to consent to registration of the easement. Unless the court vests the easement in the respondents, contrary to their wishes, it cannot be created.

14 For Royal, Mr. Melia argues that the easement has already been created with the full approbation of the City and the Committee of Adjustment. The physical structure may have been created but the easement, as a legal entity, has not been created and cannot be created until registration of deeds that create both the dominant and servient tenements.

15 The leading authority on the interpretation of **s. 100** of the ***Courts of Justice Act*** is the decision of *Trick v. Trick*.[1] In that case, under the authority of **s. 100** of the ***Courts of Justice Act***, the motions judge ordered the vesting of a debtor husband's pension in his wife to secure payment of over $225,000.00 in support arrears and almost $118,000.00 in costs. The Court of Appeal for Ontario set aside the order. At paragraph 16 of the judgment, the court said:

> 16 ...**s. 100** of the CJA does not provide stand-alone jurisdiction to grant the relief claimed. Section 100 only provides a mechanism to vest title to a property in respect of which there is a separate, valid claim to ownership.
>
> ...
>
> 19. The starting point referenced by the motion judge is **s. 100** of the CJA, which provides a court with jurisdiction to vest property in a person but only if the court also possesses the "authority to order [that the property] be disposed of, encumbered or conveyed." Thus, **s. 100** only provides a mechanism to give the applicant the ownership or possession of property to which he or she is otherwise entitled; it does not provide a free standing right to property simply because the court considers that result equitable.
>
> 20. Accordingly, the question is whether, at law or in equity, the motion judge had that necessary authority to *dispose of, encumber or convey* the appellant's interest in his pension.

16 What may be somewhat confusing or distracting in the facts of the present case is that Royal seeks, not to have some portion of respondents' lands conveyed to itself, but rather to convey or to confer a supposed benefit upon the respondents or to add a supposed benefit to respondents' title.

17 If I postulate that if the site plan agreement had required Royal *to secure a right-of-way over a portion of the respondents' lands* and that the Committee of Adjustment had somehow approved the conveyance, how would **s. 100** of the ***Courts of Justice Act*** operate? Could I order the vesting in Royal of a right-of-way over a portion of the respondents'

lands, the dominant tenement being the lands of Royal? The plain answer is no. The reason is that Royal has no claim to ownership or possession of the respondents' property. I cannot create a freestanding right.

18 Royal is asking the court to vest an **interest** in **land**, or a bundle of rights in the respondents' lands that would constitute the respondents' lands as the dominant tenement. Royal has no claim to ownership or possession of respondents' lands. Absent such a right of ownership, the court has no freestanding right to vest any **interest** in respondents' **lands** - any more than it has a right to divest the respondents of any interest in their property.

19 That is an end to the matter. This boils down to the simple example of a would-be donor attempting to force an unwilling donee to accept a gift. No such right exists in law. A donor may say that he wishes to give me a valuable horse, perhaps worth tens of thousands of dollars. I, as the prospective donee, may believe that a horse is nothing but a bundle of obligations that I do not wish to assume. The donor may have the intention to give; he may make delivery of the property; but if I am unwilling to accept the gift, it cannot be made in law.

20 I am acutely aware of the great trouble and toil to which Royal has gone in order to pursue its expansion. It may well be that the balance of convenience might favour Royal, if that were a relevant consideration. However, here the only relevant consideration is jurisdiction. I have none.

21 Application dismissed with costs.

Application dismissed.

Footnotes

1 (2006), 83 O.R. (3d) 55 (Ont. C.A.). O.C.A. per Lang J.A.

End of Document

6

1998 CarswellOnt 4564
Ontario Court of Justice, General Division

General Electric Capital Canada Inc. v. Interlink Freight Systems Inc.

1998 CarswellOnt 4564, [1998] O.J. No. 4910, 14 P.P.S.A.C. (2d) 198, 42 O.R. (3d) 348, 7 C.B.R. (4th) 173, 82 O.T.C. 335, 84 A.C.W.S. (3d) 168

General Electric Capital Canada Inc., Plaintiff and Interlink Freight Systems Inc., Defendant

Gans J.

Heard: November 3, 1998
Judgment: November 27, 1998
Docket: 98-CL-1677, B173/97

Counsel: *Miles D. O'Reilly, Q.C.*, for the Moving Party, 505417 Ontario Limited.
Michelle Vaillancourt, for the Trustee, Price Waterhouse Coopers Inc.

Subject: Corporate and Commercial; Insolvency

Headnote

Bankruptcy --- Priorities of claims — Secured claims — Forms of secured interest — Liens — Miscellaneous liens or charges

Secured creditor advanced money to bankrupt and obtained security over its assets — Unsecured creditor performed repair services on bankrupt's fleet of trucks — Unsecured creditor gave up possession of trunks upon which it had performed services but obtained acknowledgments for amounts owed — Unsecured creditor filed non-possessory claim for lien after bankrupt's assignment in bankruptcy — Trustee took position that unsecured creditor was to share pro-rata with bankrupt's other unsecured creditors — Unsecured creditor was entitled to register claim for lien after intervening bankruptcy — Registration is not mandated for perfection under Repair and Storage Liens Act — Non-possessory lien of unsecured creditor had priority over security interests of other creditors of bankrupt — Trustee to pay sum owed to unsecured creditor — Repair and Storage Liens Act, R.S.O. 1990, c. R.25.

Table of Authorities

Cases considered by *Gans J.*:

Flintoft v. Royal Bank, [1964] S.C.R. 631, 7 C.B.R. (N.S.) 78, 49 W.W.R. 301, 47 D.L.R. (2d) 141 (S.C.C.) — considered

General Electric Capital Equipment Finance Inc. v. Transland Tire Sales & Service Ltd. (1991), 6 O.R. (3d) 131, 2 P.P.S.A.C. (2d) 223 (Ont. Gen. Div.) — considered

Halpenny v. Context Systems Inc., [1982] 1 S.C.R. 559, (sub nom. *Halpenny v. Paddon*) 17 B.L.R. 1, (sub nom. *Halpenny v. Paddon*) 41 C.B.R. (N.S.) 16, (sub nom. *Halpenny v. Paddon*) 133 D.L.R. (3d) 257, (sub nom. *Halpenny v. Paddon*) 41 N.R. 451 (S.C.C.) — considered

Statutes considered:

Mechanics' Lien Act, R.S.O. 1980, c. 261
Generally — referred to

Personal Property Security Act, R.S.O. 1990, c. P.10
Generally — referred to

s. 31 — considered

Repair and Storage Liens Act, R.S.O. 1990, c. R.25
s. 1(1) — referred to

s. 3(2) — referred to

s. 7 — considered

s. 7(1) — referred to

s. 7(2) — referred to

s. 7(3) — considered

s. 7(5) — considered

s. 10 — considered

s. 10(1) — considered

s. 10(2) — considered

s. 14(1) — considered

s. 14(4) — considered

s. 16 — considered

Warehousemen's Lien Act, R.S.O. 1980, c. 529
Generally — referred to

ACTION by creditor for determination of priority of security interest.

***Gans J.*:**

Introduction

1 The *Repair and Storage Liens Act*, R.S.O. 1990, c. R.25 is an interesting piece of legislation, drawing its genesis, in part, from the *Mechanics' Lien Act* and the *Warehousemen's Lien Act*. It is at once a simple but moderately confusing statute, and one which bears certain similarities to, and major differences with, the *Personal Property Security Act*.

2 The facts giving rise to the matters in issue are not complex:

(a) Prior to 1996, the plaintiff, General Electric Capital Canada Inc. ("GE Capital") advanced money as financier to the bankrupt, Interlink Freight Systems Inc., and obtained security over its assets.

(b) In the spring of 1997, the moving party, Mr. Front-End, performed repair services on a continuing basis to the fleet of Interlink, for which it is currently owed, for purposes of this motion, the sum of $26,840.48.

(c) Mr. Front-End gave up possession of the Interlink trucks upon which it performed work and services, but obtained acknowledgments for the amounts claimed in this action.

(d) On July 4, 1997, Coopers & Lybrand Limited (now "PWCL") was appointed interim receiver and receiver and manager of the assets, property and undertaking of Interlink, effective July 6th. During the afternoon of the 4th, Interlink made an assignment in bankruptcy and appointed PWCL its Trustee.

(e) Mr. Front-End filed a non-possessory claim for lien in the prescribed form under the terms and provisions of the *RSLA* and the *PPSA* on July 14th.

Issues and Disposition

3 Although GE Capital has been paid on its security, there is now a dispute between the Trustee and Mr. Front-End over the priority to be accorded the latter's lien. The Trustee takes the position that Mr. Front-End must share pro-rata with Interlink's unsecured creditors after the payment to the remainder of the secureds. Mr. Front-End asserts the proposition that so long as its non-possessory lien is registered, it is enforceable against third parties, regardless of the fact that registration took place after the assignment in bankruptcy. (I make no distinction between the receiving order and the assignment in bankruptcy for purposes of my deliberations - particularly since counsel were unable to tell me that such a distinction should be drawn.)

4 The only issue remaining for me to determine is whether or not one is entitled to register a lien under the *RSLA* after an intervening bankruptcy.

5 In distinction to what is permitted under the *PPSA*, I hold that a non-possessory lien claimant is entitled to register its claim for lien after an intervening bankruptcy. It follows that the lien is therefore enforceable against third parties, save for *bona fide* purchasers and financiers who claim an interest in the subject matter of the lien after it arose but before registration.

Discussion

6 I have been provided with several cases, few of which interpret the *RSLA*, and some of which discuss the effect of bankruptcy and its relationship to other security-type statutes. I was also provided certain extracts from the *RSLA*. I believe, however, the starting position is to review the Act itself, in its entirety. (I would observe that I would have benefited from such a review during the course of argument.)

7 The Act in so far as it relates to a "repairer" (one who alters, improves or restores tangible personal property) is designed to create an interest in a repaired article. In the case of a possessory lien, such arises the very second the repair work is commenced, and in the case of a non-possessory lien, at the time possession is relinquished (ss. 1(1); 3(2); 7(1); and 7(2)). In the case of a non-possessory lien, it is only enforceable if the lien claimant obtains an acknowledgement of indebtedness, a matter which is not in issue in the instant case for the amount previously specified (s. 7(5)). The Act goes on to provide that a non-possessory lien has priority over the interests of "any other person", save for one who asserts a possessory lien (s. 7(3)). So long as the claim for lien is registered, the subject matter of the lien may be seized "at any time" by the sheriff (s. 14(1)), unless it is in the possession, again, of one who asserts a possessory claim for lien (s. 14(4)). Section 16 of the Act sets out, in great detail, a hierarchy of distribution for the proceeds of disposition. Basically, but for certain strictures that arise in respect to notices of an intended sale of the property, a lien claimant under the Act gets the first dollar of disposition, even before those who have perfected security interests under the *PPSA*.

8 I digress to observe that this last mentioned section, s. 16, is consonant with s. 31 of the *PPSA*, which provides as follows:

> Where a person in the ordinary course of business furnishes material or services with respect to goods that are subject to a security interest, any lien that the person has in respect of the materials or services has priority over a perfected security interest...

9 Section 31 of the *PPSA* and its relationship with the *RSLA* was, in some respects, the focus of attention of Mr. Justice Langdon in *General Electric Capital Equipment Finance Inc. v. Transland Tire Sales & Service Ltd.* (1991), 6 O.R. (3d) 131 (Ont. Gen. Div.). In that case, Mr. Justice Landgon held that one's priority under the *RSLA* is established as a result of the combined operation of s. 31 of the *PPSA* and s. 7(3) of the *RSLA*, the latter of which provides as follows:

> A non-possessory lien has priority over the interest in the article of any other person other than a lien claimant who is claiming a lien under Part I, and, where more than one non-possessory lien is claimed in the same article, priority shall be determined according to the same rules of priority as govern distribution of proceeds under section 16. [Emphasis added.]

10 In some respects, part of the problem before me is created by the grammatically deficient structure of s. 10(1) of the *RSLA*, which reads as follows:

> A non-possessory lien is enforceable against third parties only if a claim for lien has been registered, and, where a person acquires a right against an article after a non-possessory lien arises, the right of the person has priority over the non-possessory lien of the lien claimant if a claim for lien was not registered before the person acquired the right.

11 The second half of that "run-on sentence" poses a problem. It provides that a non-possessory lien is subordinate to a "secured" interest arising after the creation of the non- possessory lien but before the time of the registration of the lien. Other than its relationship to the last mentioned "intervening" interest, the first "phrase" of the section merely mandates registration before a claimant can realize upon the "article" by seizure and sale. I must confess the rationale for the first phrase, absent its relationship to the second, escapes me.

12 As was suggested by counsel for the lien claimant, and as is underscored in the decision of Mr. Justice Landgon, the *RSLA* is designed to protect persons who bestow a benefit upon an article without requiring them to undertake a whole range of searches before the work is commenced. Once the lien is created, a priority exists not only against the owner, or one claiming under the owner, but in relation to others, including secured creditors. The rationale for this anomaly of commerce is obvious: repair work to chattels would not be done expeditiously or the costs attendant to such work would be increased exponentially were a registry search required prior to repairs commencing.

13 That being said, but for the portion of s. 10(1) that I have referred to as "notice before sale", it is my view that the legislature, in an attempt to balance competing interests, intended to except as subordinate to the lien claimant those who obtained an interest in the liened article "in the interim" by way of purchase or loan.

14 The Trustee relies upon the decision of the Supreme Court of Canada in *Halpenny v. Context Systems Inc.* (1982), 133 D.L.R. (3d) 257 (S.C.C.), in support of her assertion that a bankruptcy crystallizes the rights of creditors and that nothing can transpire after the date of bankruptcy such that a bankrupt can give effect, as it were, to the security. This case and those which I have noted up involved either the *PPSA* or its "predecessor" statutes which, as best as I understand, require registration as a precondition to the perfection of one's security interest. In my view, such is not the regime under which the *RSLA* is designed to operate.

15 Furthermore, there is nothing in the *RSLA* that makes registration a time-sensitive issue. Indeed, a claim for lien may be registered "at any time after an acknowledgment of indebtedness has been signed" (s. 10(2)), and the article may

be seized "at any time" after registration of the claim for lien (s. 14(1)). Registration is not mandated for perfection, and as an aside, there are no provisions which relieve against late registration.

16 Initially, I was of the view that s. 7 only dealt with a lien claimant's rights *vis-a-vis* an "owner", whereas s. 10 set out the drill in respect of the competing interests of the lien claimant and other secured creditors. I fell victim to the same fault in logic readily identified by Mr. Justice Langdon when he observed that there was a distinction to be drawn between "priority" and "enforceability", the former of which, to use the vernacular, is created from the get-go.

17 Counsel for the Trustee-Receiver argued, in the alternative, that her client, on the bankruptcy and/or at the time of the receiving order became a "third party", under s. 10(1), and therefore acquired rights in the intervening time period. I cannot accept this submission. In the first place, a trustee or a court-appointed receiver/manager has no higher right than the bankrupt and takes the property of the bankrupt as a successor in interest and not as a purchaser for value without notice (*Flintoft v. Royal Bank*, [1964] S.C.R. 631 (S.C.C.)). As previously discussed, the second half of s. 10(1) is designed to protect *bona fide* purchasers or lenders whose interest is created in the interim. Additionally, if one were to accede to the argument advanced by the Trustee's counsel, one would effectively negate the purpose of the *RSLA* by not granting to a repairer a priority to the extent of the article's betterment. Finally, this argument would permit third parties to improve upon their position because of a bankruptcy or receivership by eliminating the priority created by the Act, a result not contemplated by the legislation.

18 I therefore hold that the non-possessory lien of Mr. Front-End has priority over the security interests of the other creditors of Interlink and hereby order the Receiver and Manager or Trustee to pay the sum of $26,840.48 to the moving party.

19 If counsel are unable to agree on the disposition as to costs, I may be contacted within ten days from the release of these reasons for judgment to arrange a time convenient for the argument of the costs issue.

Order accordingly.

7

2005 CarswellOnt 9255
Ontario Superior Court of Justice

Eby v. Pitkin

2005 CarswellOnt 9255

Jim Eby, Plaintiff and Brian Pitkin, Defendant and White Queen Limited and 869868 Ontario Inc.

Wilson J.

Judgment: March 9, 2005
Docket: None given.

Proceedings: affirmed *Eby v. Pitkin* (2006), 2006 CarswellOnt 7277, 218 O.A.C. 234 (Ont. Div. Ct.); additional reasons at *Eby v. Pitkin* (2007), 2007 CarswellOnt 3469 (Ont. Div. Ct.)

Counsel: M. Greenglass, for Defendant / Third Party
J.R. Hart, for Plaintiff
B.H. Borlack, for Third Party
P.N. Bourque, for Defendant
V. Tanner, for Defendant / Third Party

Subject: Corporate and Commercial; Torts; Public; Property; Contracts

Headnote

Law enforcement agencies --- Sheriffs and bailiffs — Liabilities — Bailiff — Miscellaneous

Plaintiff was contractor who had equipment stored at commercial landlord's premises — Plaintiff was in arrears and contacted landlord to propose that he pay half of arrears in two weeks, and other half in further two weeks — Landlord refused and locked plaintiff out, with his equipment inside — Plaintiff forced lock to use equipment — Landlord had bailiff retain storage company to remove and store plaintiff's equipment — Storage company was directed by bailiff to sell equipment at auction — Equipment was sold for total of $5,980.20, of which plaintiff received $552.49 — Plaintiff brought action for damages for loss of material, equipment and tools — Action allowed in part — Claim was not statute barred by six-year limitation period as triggering date was either date of sale or date that plaintiff became aware that goods had been sold without notification to him — Plaintiff did not abandon goods, and therefore bailiff was not voluntary bailee, and Repair and Storage Liens Act applied, requiring that plaintiff be given notice of sale — Bailiff did not provide landlord or tenant information to storage company — Plaintiff was entitled to actual damages suffered, which he claimed to be $75,000 — Plaintiff had replaced tools on as-needed basis since seizure, and total cost of replaced tools was $25,000 — Damages assessed at $22,000, less amount already received by plaintiff.

Table of Authorities

Cases considered by *Wilson J.*:

Ashton v. Steg (1992), 1992 CarswellBC 1945 (B.C. S.C.) — followed

Booy v. Genstar Development Co. (1998), 1998 CarswellBC 966 (B.C. S.C.) — considered

July v. Neal (1986), 1986 CarswellOnt 446, 57 O.R. (2d) 129, 32 D.L.R. (4th) 463, 17 O.A.C. 390, 19 C.C.L.I. 230, 12 C.P.C. (2d) 303, [1986] I.L.R. 1-2126, 44 M.V.R. 1 (Ont. C.A.) — followed

Statutes considered:

Commercial Tenancies Act, R.S.O. 1990, c. L.7
Generally — referred to

Repair and Storage Liens Act, R.S.O. 1990, c. R.25
Generally — referred to

s. 1(1) "storer" — referred to

s. 15 — referred to

s. 15(1) — referred to

s. 21 — referred to

Warehousemen's Lien Act, R.S.O. 1980, c. 529
Generally — referred to

ACTION by plaintiff for damages for loss of equipment seized and sold at auction without notice.

***Wilson J.*:**

1 In this action, commenced August 13th, 1997, Mr. James Eby (Eby) claims damages in the amount of $75,000 for losses of his material, equipment and tools, which were stored and sold at auction upon instruction of the defendant bailiff, Brian Pitkin. Eby carries on work as a contractor with a specialty in counter tops for kitchen and bathrooms.

2 The physical storage of the goods and auction were conducted by the third party, White Queen Limited. The goods were seized and sold at auction, as Eby was two to three months in arrears of rent for the premises known as 373 Adelaide Street East (The Rental Premises).

3 Eby claims that the sale was conducted pursuant to The Landlord and Tenant Act, and The Repair and Storage Liens Act, RSO 1990 (RSLA). After the goods were seized, no notice of the sale was provided to Eby by Pitkin or White Queen in accordance with Section 15 of the RSLA. Therefore, Eby asserts he is entitled to damages in accordance with Section 21 of the Act.

4 The defendant and the third parties assert that the RSLA does not apply, as Eby abandoned his goods. Therefore, the common law of an involuntary bailee applies. Under the common law, there is no notice requirement, and the bailee is simply required to act reasonably in the circumstances of the case.

5 The defendant and third party assert that Pitkin provided Eby with an opportunity to collect his goods, but he did not do so, and the goods were in essence abandoned. Pitkin asserts that he acted reasonably in the circumstances.

6 If the RSLA applies, the defendant and third parties suggest that there are no damages. First even if Eby received notice, he was not in a financial position to redeem. As well, he failed to mitigate his damages as he could have obtained the goods based upon Eby's own evidence for the payment of $2,000 at the initial seizure or $3,000 the day after. As well, the defendants and third parties take the position that the alleged damages have not been adequately proven.

7 In the third party proceedings, Pitman asserts that White Queen was responsible for the breach of any notice requirements, if there was such a notice requirement. As well, he asserts that the third party, 869868 Ontario Inc., is the owner of the Rental Premises, and, hence, is responsible for any damages accrued.

Credibility and Preliminary Findings of Fact:

8 Mr. Eby testified at some length. Not all of his evidence made sense, but much of it does. I accept most, but not all of his evidence as I will outline.

9 I accept his evidence that he anticipated receiving notice of the goods received and that pending receipt of the notice he was scrambling to finish an outstanding contract on two counter tops to attempt to make good the arrears or to find alternative premises.

10 Eby has a history of arrears with respect to commercial landlords. He was evicted from his previous premises shortly before taking possession of the Rental Premises. He did not advise the owner landlord of his previous difficulty. In 1993, after this incident, he was again in arrears of rent and was evicted from a third premise.

11 It appears that Mr. Eby lived a hand-to-mouth existence. He appeared — at least during the period in question — to be struggling to make ends meet. He has worked as a small time contractor for some 30 years. His tools accumulated over the years, and his materials were all he apparently owned.

12 At the time of the eviction in either late May or early June 1991, the rent was in arrears totalling either $1,500, or $2,250.

13 I accept Eby's evidence that he contacted the landlord Clifford Waxman directly to propose to pay half of the arrears in two weeks, and the other half in a further two weeks. He hoped to finish the current job to get paid, and make good his rent arrears. I accept that in 1999 business was poor. Jordon Carp, the Realtor involved on behalf of the landlord, indicated that Eby's proposal was "not good enough."

14 I conclude that Eby probably forced the locks on the premises after the initial lock out. Eby continued working at night to try to finish the job and earn some cash. When the agent, Carp, discovered Eby at the premises, he was angry. Pitkin retained White Queen to store the goods immediately thereafter. The next day, White Queen attended and moved the plaintiff's goods over a sequence of two days.

15 Pitkin is an experienced sheriff and bailiff. Over the years, he has been involved in many, many evictions. He came across as being a straight forward, no nonsense professional when he testified. I accept most, but not all of his evidence.

16 At the time of this incident, he was performing in-house bailiff functions for the law firm of Goodman & Goodman. All of his documents with respect to the incident were unfortunately destroyed in a flood in Mr. Pitkin's basement in 1995. As well, the Goodman file was not available due to the passage of time.

17 I accept Pitkin's evidence that the instructing counsel and Realtor of the landlord were initially agitated and playing "hard ball". They wanted Eby out. They initially instructed Pitkin to take his goods and sell them and offset the rent. The landlord was not prepared to negotiate, and I accept that Pitkin advised the landlord of the minimum legal requirements.

18 Pitkin confirmed in his evidence that Eby had contacted the landlord to discuss the payment of rent but the landlord was not interested. Pitkin confirmed that Eby needed time to remove goods, as he had to find an alternative place to conduct business.

19 I do not accept Pitkin's suggestion that he may have advised Eby in writing with respect to the auction sale, or of the intended auction sale, nor I do I accept any suggestion that he may have told Mr. Weizenblack, the principal of White Queen, the name and address of Eby to allow White Queen to comply with any notice requirements.

20 Mr. Weizenblack, the principal of White Queen, testified. I accept his evidence. He was acting on instructions from Pitkin. I accept that he was never instructed to notify the tenant, Eby, of the proposed sale. In fact, he was not aware of either the name of the tenant or the landlord.

21 The evidence is not clear whether Weizenblack advised Pitkin with respect to the date of the sale. It appears that he may have. It is clear when Eby phoned Pitkin in early September 1991, Pitkin advised Eby that the sale had occurred on August 13th, 1991.

Limitation Issue:

22 The defendant, Pitkin, and third parties assert that this action is statute barred. It is not disputed that this action is subject to a six-year limitation period.

23 The notice of action in this case was issued on August 12, 1997 - six years less a day from the date that the goods of Eby were sold in a public auction.

The Prior Motion:

24 The defendant and third parties moved before Sachs, J., before trial for an order dismissing the action as statute barred. She concluded that there was a triable issue as to what date triggered the limitation period based on the discoverability rule. Potential dates include the date of seizure of the goods, this is June 1991, which reflects the position of the defendant and the third parties, or the date of the sale, August 13, 1991, which reflects the position of the plaintiff.

25 Two alternative dates are also possible. It could be the date that Eby became aware of the sale in early September 1991, or as well it could be the date that Mr. Eby was provided with an accounting and report with respect to the sale on October 7th, 1991.

The Law:

26 McKinnon, J.A., in *July v. Neal* (1986), 57 O.R. (2d) 129 (Ont. C.A.), outlines the applicable test at page 135 with respect to the test of discoverability that a cause of action exists. He states:

> "I have concluded that the time begins to run under such circumstances as the instant case, when the material facts on which the claim is based have been discovered or ought to have been discovered by the plaintiff by the exercise of reasonable diligence: *Central Trust Co. v. Rafuse, et al.*

He then goes on to say:

> The former solicitor for the appellant, in an affidavit filed on the motion, stated it was not until the examination for discovery of all parties on April 11, 1984, that it became apparent that the possibility existed that no liability would attach to the defendant, but rather that all liability would "rest" with the unidentified third vehicle. It will be the responsibility of the trial judge on hearing the evidence to determine whether the material facts by the exercise of reasonable diligence, ought to have been discovered earlier, and the date from which the limitation period should run.

27 The following are the facts accepted by me relevant to the limitation issue.

28 I accept Pitkin's evidence that initially he obtained instruction from counsel at Goodman's to lock out the tenant for nonpayment of rent and to sell goods and to recoup some of the rental losses.

29 Pitkin explained that such action was not lawful. If the landlord wished to pursue rental arrears, the tenant had to be allowed a period to pay the outstanding arrears and remain in the premises.

30 I accept the evidence of Pitkin that the landlord decided not to pursue the rent arrears and decided to terminate the tenancy and obtain immediate possession. Pitkin attended the premises on the solicitor's instruction and changed the lock on the front door with the assistance of a locksmith.

31 It is conceded by Pitkin that the goods sold at auction were the property of Eby, subject to the storage liens until the date of the sale.

32 As well, I accept the evidence of Pitkin that after the initial lockout, the landlord was enraged to find out Eby had returned to the premises surreptitiously to try to finish the job on the two counter tops. Counsel instructed Pitkin to put all of Eby's possessions outside of the premises on the sidewalk. Pitkin confirmed that the appropriate course of action was to store, and, if necessary, sell the goods.

33 Counsel for the landlord in turn undertook to pay the storage and moving fees. White Queen was retained by Pitkin to immediately empty the premises and store the goods.

34 I accept the evidence of Eby that he attended at the premises one day in June and saw a truck loading his goods. He was told by Pitkin that the proceedings would cease if he paid the sum of $2,000. He did not at that point in time, have the funds. The next day, when the truck returned, after taking the initial load to White Queen, Pitkin told Eby that he could have his goods if he paid the sum of $3,000. Again, he did not have these funds.

35 I accept the evidence of Eby and Pitkin that he wanted to make arrangements to remove his belongs and finish the counter tops and obtain alternative rental premises. I do not accept the suggestion of accept the defence that Eby at any time abandoned his goods, tools, and materials.

36 I conclude, when counsel for the landlord learned that Eby had returned to the premises in an attempt to finish the two counter tops, the reaction was swift and immediate. He wanted to put Eby's items on the sidewalk, but as urged by Pitkin with conformity with his obligation in law, Pitkin made arrangements for the immediate removal and storage of Eby's goods.

37 I accept the evidence of Eby that he did not receive notice of the auction sale from Pitkin, White Queen, or 869868 Ontario Limited. I accept as well his evidence that he expected to receive notice of the sale and intended to take steps with respect to his goods.

38 I accept his evidence that he telephoned Pitkin to make inquiries about the goods on September 4th, or 7th, 1991. At that time, he found out that the goods had been sold. He had received a check approximately one month later in the amount of $552.49 from Pitkin and received as well an accounting with respect to the auction proceeds which totalled some $5980.20.

Conclusions with Respect to Limitation Defence:

39 I conclude that the date triggering the limitation period was perhaps the date of the auction sale; that is, August 13, 1991, but more probably the date that Eby became aware that the goods had been sold without notification to him; that is, September 4 or 7th, 1991. Until that time, I accept that Eby understood that his goods were being stored, and that he would receive no notice of any sale. Given my finding with respect to the law, his actions were reasonable.

40 I do not agree with the submission from counsel for the defence for the third party that the cause of action arose when goods were initially seized.

41 I accept the plaintiff's evidence that it was his hope to finish his present contract on the two counter tops, sort out the mess he was in, recoup his personal items and find an alternative premises.

42 For these reasons, I conclude therefore that the claim is not statute barred by the six-year limitation period.

43 The next issue is the applicability of the RSLA.

Applicability of the RSLA

44 If the Repair and Storage Act Lien Act applies, then notice is required to Eby of any sale. If there is a default in this requirement, then the party responsible for notice is required to pay damages. I refer to the definition of "storer" in the third section of The Repair and Storage Liens, and I refer to section 15 and 21 of the RLSA.

> a 'storer' means a person that receives an article for storage or storage and repair on the understanding that the person will be paid for the storage or storage and repair as the case may be.

15.-(1) provides:

> A lien claimant who has a right, under this Act, to sell an article shall not exercise that right unless the lien claimant has given notice of intention to sell the article.

Section 21 provides:

> A lien claimant who fails to comply with the requirements of this Part is liable to any person who suffers damages as a result and shall pay the person an amount equal to the greater of $200 or the actual damages.

45 If the RSLA does not apply, then the landlord and bailiff were required to meet the standard of care of an involuntary bailee. That standard is described by Legget J., in *Booy v. Genstar Development Co.*, [1998] B.C.J. No. 1074 (B.C. S.C.). Legget J. States at paragraph 30:

> The facts in this case are clear that "Mr. Booy, because of his unfortunate situation in losing his lease, elected to abandon his property on the site. He had time to remove it and did not do so. Even if the goods had not been abandoned, the standard as an involuntary bailee would be a low one requiring no more than due care and diligence for the goods upon which it took possession. The duty as a gratuitous bailee is only to refrain from international and possibly reckless damage and this standard falls below that of gross negligence."

46 I note in *Booy* that the plaintiff had nine months notice which was judged by the court to be adequate to allow him remove his belongings.

47 Pitkin asserts two alternative arguments. First, he states that Eby abandoned his goods, and therefore the goods were abandoned and stored as an involuntary bailee. For reasons previously outlined, I do not accept that Eby ever intended to abandon his goods. Pitkins and White Queen were not therefore a voluntary bailee. Prima facie, they were storing the goods under The Repair and Storage Lien Act.

48 Pitkin also asserts that he was bailee and not the storer of the goods, and, therefore, the Act does not apply to him. He argues, if there is a notice requirement, it is the obligation of White Queen, who was not sued by the plaintiff. So, the argument goes, the plaintiff cannot obtain relief by the RSLA.

49 Respectfully, this interpretation is essentially a literal one, which would defeat the intended purpose of the legislation; which is to protect people whose goods are being stored. Pitkin, as bailee, instructed White Queen to store, and, at some point, sell the goods. I accept the evidence of Mr. Weizenblack that White Queen was never provided any particulars with respect to the name of the tenant nor the landlord.

50 Pitkin retained White Queen perhaps in an agency relation to store and sell the goods on his behalf. Pitkin was, according to his evidence, in the process of changing jobs when this sale occurred. There was obviously a breakdown in communication between Pitkin and White Queen with respect to responsibility to notify Eby with respect to the proposed sale.

51 I do not accept Pitkin's evidence that he "would have" written to Eby to advise him of the sale.

52 Mr. Weizenblat in the notice of auction prepared by White Queen on instructions by the bailiff confirmed that the sale was proceeded and authorized by the bailiff pursuant to The Landlord and Tenant Act and as well to The Warehouse Lien Act. This legislation was the predecessor of the RSLA and had been repealed and replaced by the RSLA on the date of the sale. As Mr. Weizenblat indicated, referring to The Warehousemen's Lien Act, rather than to the RSLA was an honest mistake.

53 I note, however, that both the predecessor legislation, that is The Warehousemen's Lien Act and the RSLA, have notice requirements with respect to a sale to the owner of the stored goods.

54 I conclude that the RSLA applies. Pitkin cannot escape legal responsibility for notice pursuant to the Act when he instructs White Queen and authorizes the sale. Pitkin, as indicated, came across as a competent professional. I suspect in the job shuffle and the breakdown of communication, Pitkin and White Queen failed to provide notice to Eby of the sale. It was unfortunately forgotten. Mistakes do happen.

55 If I am incorrect that the RSLA applies, or that Pitkin is a storer in accordance with the provisions of the RSLA, then, in my view, in accordance with his common law obligations and the facts and circumstances of this case, notice should have been provided to Eby before a sale. Pitkin is required to act reasonably. What is reasonable is dependant upon the facts of each case.

56 I have found conclusively that the goods were never abandoned. In my view, in the circumstances, notice to the owner of the goods before sale would be a reasonable requirement, given the fact that the goods were not abandoned and the speed and animosity of the events that occurred in June of 1991.

Damages:

57 If the notice provision of the RSLA apply and were not complied with, in accordance with Section 21 of the Act, the plaintiff is entitled to be compensated for "actual damages suffered".

58 It is with respect to the proof of damages that the plaintiff has difficulty.

59 He prepared an inventory list prior to the eviction, which is found at tab 2 of the document brief. No serious issue was taken by Pitkin or by Mr. Weizenblat, the principal of White Queen, with respect to the contents of that inventory list. Their dispute is with respect to value.

60 Eby has "guestimated" without any backup, the current fair market value of these items today. Many of the items included tools which were used. Although, I accept that they were tools of quality, there is no evidence before me of what a realistic depreciated value of those items and tools would have been at the date of seizure.

61 Tab 4 in Exhibit 1 is a list of items that have been purchased by the plaintiff after the date that he was locked out and after the date of the sale. The total of that list is some $25,000, but I note that it's basically from 1991 to date. The list at tab 4 is not cross referenced to the list of items at tab 2. For instance, counsel pointed out that three staple guns appeared on the list at tab 4 and none appear on the original list under tab 2.

62 Counsel for the plaintiff suggests that the current fair market value is not the appropriate price, nor is the auction price. He relies upon the principles in *Ashton v. Steg*, [1992] B.C.J. No. 1347 (B.C. S.C.) At page 7 for guidance. Justice Murphy cites a case of Justice Houghton, which outlines some principles that are useful:

> "Accordingly, the plaintiff is entitled to damages on the basis of conversion, which I understand to be the "value of the thing converted and any special damages which the plaintiff can prove."

He goes on to say:

> Neither basis of valuation contended for by the respective parties is, in my view, in accordance with the accepted principles of determination of the value of things converted. The plaintiff is not entitled to the cost of replacing used tools by new tools, nor is he compelled to accept the equivalent of the price which such a miscellaneous assortment of articles might fetch at public auction.

63 These comments are very apt, given the evidence before me. When the plaintiff's goods were unloaded at White Queen, an inventory was prepared by White Queen in writing. Unfortunately, through the passage of time, those documents are no longer available.

64 Mr. Weizenblat fairly confirmed, however, that a lot of items of value were removed from the premises and sold at auction. He didn't contest the accuracy of the inventory list. He also confirmed candidly that the best value is not achieved at a public auction.

65 Counsel for the plaintiff suggests that the appropriate discount, having regard to the principles outlined in *Ashton v. Steg* upon the amounts claimed by the plaintiff, taking into account the age of many of the tools, would be a 50 percent discount. This would reduce plaintiff's claim of $37,500.

66 I note that Eby has replaced tools on an as-needed basis since the seizure based on various work he has performed. The total of these expenses is some $25,000.

67 Difficulty in assessing damages is not a reason not to do so. Although the proof in this case is less than ideal.

68 I am required to assess the damages at somewhere between auction price, which is agreed to be $5,980.20 and the new replacement value which Mr. Eby suggests is $75,000.

69 I accept the suggestion of counsel for the plaintiff that there should be a significant depreciation from the $75,000 to take into account the fact that these items were used. I note that neither Pitkin, as an experienced bailiff, or Weizenblat, an experienced owner of an auction house, quarreled with the figures placed upon the inventory provided by Mr. Eby. They had an opportunity to provide evidence with respect to this, and Mr. Weizenblat certainly had personal knowledge on this income and chose not to do so.

70 Having regard to all of the facts and circumstances that apply, I conclude that the value is somewhere between — and having regard to the auction price of $5,980.20, the replacement of the tools to date being $25,000, and the estimated value of new tools totalling $75,000. I assess the damages as being $22,000.

71 The defence suggests that even if Eby had received notice of the sale, that there was no guarantee that he would have redeemed or recouped his tools and materials.

72 I accept Eby's evidence that he is in essence a survivor. When his back is to the wall, he is usually able to come up with something.

73 It is acknowledged by Pitkin that some of the deductions from the auction proceeds were the responsibility of the landlord. That would include a fee for changing the locks, as well as the bailiff's fees.

74 I conclude, on the balance of probabilities, that had Eby received notice of the sale, that he would have been able to cobble together the storage, removal, and, if necessary, advertising fees to recoup what was for him his lifetime of work - his tools and materials.

75 Therefore, I grant judgment in favour of the plaintiff against Pitkin in the amount of $22,000, less the amount he has already received which is $552.49.

76 I turn now to consider the third party claims.

Third Party Claims:

77 Pitkin has made a third party claim against two parties, the numbered company 869868 Ontario Limited and White Queen.

78 I will first consider the issue with respect to the numbered company. Pitkin testified, and I accept his evidence that he was retained by the law firm of Goodman & Goodman to conduct the eviction on behalf of the landlord. At that time, Pitkin was working in house for Goodman & Goodman.

79 There are no documents available either in Pitkin's file, which was destroyed in a flood, or with Goodman.

80 Pitkin's third party against 869868 is based upon a title search which he apparently conducted upon the Rental Premises. It appears clear that 869868 was, in June of 1991, a co-owner of the property in question. However, it appears that the lease was with the original owner of the property; that is, with 804634 Ontario Limited.

81 It is not clear when 869868 acquired the interest in the Rental Premises. The pleadings indicate that the interest was acquired after Eby signed the 18-month lease with 804634 Limited. It appears that the wrong company may have been named by Pitkin as 869868 may have had no interest in the rental premises when the lease was signed.

82 I note, however, that the management agreement, which was filed as an exhibit and dated 1989, appears to show 869868 as a co-owner of several properties, including part lot 12 on Adelaide Street East in Toronto, which I assume to be the Rental Property.

83 The evidence obviously is not clear on ownership. Another complication with respect to the appropriate party is that the management agreement confirmed that, in fact, CIBC Development Corporation was retained as manager to supervise all leasing operations and management of the Rental Premises. This includes by the terms of the management agreement responsibility for collecting rent arrears or any legal proceedings.

84 Although I am satisfied that Pitkin was retained by Goodman to act on behalf of the landlord, I am not satisfied on the balance of probabilities that 869868 was the landlord. Hence, the responsibility of the landlord for Pitkin's actions in the third party claim must be dismissed.

Third Party Claim by Pitman Against White Queen:

85 As I've indicated, I accept the evidence of the principal of White Queen that the only instructions were to store and sell the goods. These instructions came from Pitman, not from the landlord.

86 I accept Mr. Weizenblack's evidence that he did not know the name of either the landlord nor of the tenant, and he was not advised of this by Pitkin.

87 In the circumstances, I conclude that there can be no liability on behalf of White Queen for failure to provide notice to Eby of the sale of his goods. This aspect of the third party claim is therefore also dismissed.

88 — Ruling concluded

Action allowed in part.

THIRD EYE CAPITAL CORPORATION
Applicant

-and-

DIANOR RESOURCES INC.
Respondent

Court File No. CV-15-11080-00CL

ONTARIO
SUPERIOR COURT OF JUSTICE
COMMERCIAL LIST

PROCEEDING COMMENCED AT
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BOOK OF AUTHORITIES

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RCP-E 4C (July 1, 2007)