Form 49

[Rule 13.19]

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COURT	Court of Queen's Bench of Alberta
JUDICIAL CENTRE	Calgary
Applicant	IN THE MATTER OF THE *COMPANIES' CREDITORS ARRANGEMENT ACT*, R.S.C. 1985, c. C-36, as amended AND IN THE MATTER OF A PLAN OF COMPROMISE OR ARRANGEMENT OF LIGHTSTREAM RESOURCES LTD, 1863359 ALBERTA LTD, LTS RESOURCES PARTNERSHIP, 186330 ALBERTA LTD AND BAKKEN RESOURCES PARTNERSHIP
DOCUMENT	**BOOK OF AUTHORITIES OF APOLLO MANAGEMENT, L.P. AND GSO CAPITAL PARTNERS** **VOL. 2 OF 2**
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Date: November 15 and 16, 2016
Time: 10:00am

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2012 BCSC 1591
British Columbia Supreme Court

Lemare Holdings Ltd., Re

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

In the Matter of the Business Corporations Act, S.B.C. 2002, c. 57, As Amended

In the Matter of a Plan of Compromise or Arrangement of Lemare Holdings Ltd., Lemare Lake Logging Ltd., Lone Tree Logging Ltd., C.&E. Roadbuilders Ltd., Coast Dryland Services Ltd., Dominion Log Sort Ltd., and Central Coast Industries Ltd. (Petitioners)

Grauer J.

Heard: October 16, 18, 19, 2012
Judgment: October 26, 2012
Docket: Vancouver S124409

Counsel: K. Denhoff, D. Dahlke for Petitioners October 16, 2012
M. Buttery, L. Williams for Petitioners October 18, 19, 2012
R. Payne, M. Weintraub for Her Majesty The Queen in Right of the Province of British Columbia on October 16, 2012
D. Hatter, S. Davis for Her Majesty The Queen in Right of the Province of British Columbia on October 18, 19, 2012
R. Morse for Toronto-Dominion Bank, TD Equipment Finance Canada Inc.
M. Verbrugge for Monitor

Subject: Insolvency; Civil Practice and Procedure; Natural Resources

Headnote

Bankruptcy and insolvency --- Companies' Creditors Arrangement Act — General principles — Jurisdiction — Court

Petitioner company obtained initial order pursuant to Companies' Creditors Arrangement Act (CCAA), including stay of proceedings until comeback hearing — Province provided proposal letters to company respecting stumpage and penalty owing, but did not obtain lien over unsecured creditors because it did not issue assessment due to stay of proceedings — Company brought application for extension of stay and for claims process order (CPO) — Province brought application to set aside initial order or to terminate stay — Company's application granted; province's application dismissed — Court had jurisdiction to make initial order — Company was "debtor company" because it was insolvent, according to totality of evidence — There was looming liquidity crisis that would deprive company of ability to pay its debts as they became due without benefit of stay — Province's proposed assessed stumpage and penalties totalling over $12 million qualified as contingent claims — In addition, company had $10 million liability for trust loan — Court should not have declined to exercise jurisdiction to make initial order — Province's assessment and penalties could be dealt with by compromise or arrangement under s. 19(1) of CCAA.

Bankruptcy and insolvency --- Companies' Creditors Arrangement Act — Initial application — Lifting of stay

Petitioner company obtained initial order pursuant to Companies' Creditors Arrangement Act (CCAA), including stay of proceedings until comeback hearing — Province provided proposal letters to company respecting stumpage and penalty owing, but did not obtain lien over unsecured creditors because it did not issue assessment due to stay of proceedings — Company brought application for extension of stay and for claims process order (CPO) — Province brought application to set aside initial order or to terminate stay — Company's application granted; province's application dismissed — Court had jurisdiction to make initial order — Company was "debtor company" because it was insolvent, according to totality of evidence — There was looming liquidity crisis that would deprive company of ability to pay its debts as they became due without benefit of stay — Province's proposed assessed stumpage and penalties totalling over $12 million qualified as contingent claims — In addition, company had $10 million liability for trust loan — Court should not have declined to exercise jurisdiction to make initial order — Province's assessment and penalties could be dealt with by compromise or arrangement under s. 19(1) of CCAA.

Bankruptcy and insolvency --- Companies' Creditors Arrangement Act — Initial application — Grant of stay — Extension of order

Petitioner company obtained initial order pursuant to Companies' Creditors Arrangement Act (CCAA), including stay of proceedings until comeback hearing — Province provided proposal letters to company respecting stumpage and penalty owing, but did not obtain lien over unsecured creditors because it did not issue assessment due to stay of proceedings — Company brought application for extension of stay and for claims process order (CPO) — Application granted — CPO was granted, subject to certain modification — Stay was extended — All that province would lose in CPO was time-consuming step of appeal by company to Minister of of Forests, Lands and Natural Resource Operations, which did not amount to prejudice to province — Fairness did not require modification of stay to permit province to proceed to assessment — Appropriate provision could be made to facilitate crystallization in claims process that preserved to province ability to take full advantage of onus and proof provisions that it would have under Forest Act process.

Bankruptcy and insolvency --- Companies' Creditors Arrangement Act — Initial application — Miscellaneous

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Bankruptcy and insolvency --- Companies' Creditors Arrangement Act — Initial application — Procedure — Miscellaneous

Evidence — Petitioner company obtained initial order pursuant to Companies' Creditors Arrangement Act, including stay of proceedings until comeback hearing — Company brought application for extension of stay and for claims process order (CPO) — Province brought application to set aside initial order or to terminate stay — Company brought application to exclude evidence within province's application — Application for extension of stay and CPO was granted; application for exclusion of evidence was granted in part; province's application was dismissed — Objectionable evidence consisted of province's affidavit that stated that company refused to comply with province's demand to inspect certain materials — Province had returned materials pursuant to court order quashing province's warrants, but attempted immediately to seize them again by relying on information it obtained unlawfully — Two lines of affidavit were struck out that referred to company's refusal to permit inspection of returned materials.

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APPLICATION by petitioner company for further stay and claims process order; APPLICATION by province to set aside initial order or terminating stay; APPLICATION by petitioner to exclude evidence within province's application.

***Grauer J.*:**

Introduction

1 On June 21, 2012, on the *ex parte* application of the petitioners, I granted an Initial Order pursuant to the *Companies' Creditors Arrangement Act*, R.S.C. 1985, c. C-36 (the CCAA) granting relief that included a stay of proceedings until the comeback hearing, which I set for July 20, 2012, and appointing Alvarez & Marsal Canada Inc. as monitor on behalf of the Court.

2 On July 20, 2012, the petitioners sought an extension of the stay, and the pronouncement of a claims process order (CPO). Counsel for Her Majesty The Queen in Right of the Province of British Columbia (the Province) advised that they wished to apply to set aside the initial order, but were not ready to proceed. They asked for an adjournment. Unhappy with their delay, I denied the adjournment, but as things turned out, that is what happened anyway. What was understood at the time was that the Province and the petitioners were to discuss a means of dealing with the Province's claim within the CCAA process. They were unable to come to an agreement.

3 On September 6, 2012, we reconvened to hear the Province's application, but the petitioners objected to the admissibility of certain evidence that the Province sought to adduce. Counsel for the Province argued that he was not in a position to deal with that objection notwithstanding that the petitioners had raised their concern as soon as the affidavits in question were delivered. Still unhappy with the delay, I nevertheless granted the adjournment given the basis of the objection, and I directed the petitioners to put their objection into the form of an application.

4 On October 16, 2012, I heard the petitioners' application to exclude evidence. I gave my ruling at the end of the day with reasons to follow. On October 18 and 19, 2012, nearly four months after my Initial Order, I heard the Province's application for an order setting that order aside, or alternatively terminating the stay. I also heard the petitioners' application for a further stay and a claims process order.

5 What follows are my reasons on all three applications.

Background

6 The petitioners, whom I shall describe collectively as Lemare, constitute an integrated forestry business located on northern Vancouver Island, where they are a major employer.

7 For some considerable time, Lemare has been at loggerheads with the Province, particularly what is now styled the Ministry of Forests, Lands and Natural Resource Operations (MOF), over stumpage that the Province claims Lemare owes and has not paid due to wilful under- and non-reporting. Nothing in these reasons addresses the merits of that claim.

8 Various aspects of that dispute, other than its merits, have occupied a significant amount of Court time over the last several years, the circumstances of which have given rise to considerable acrimony between the parties. On three separate occasions, this Court has quashed warrants obtained by the Province pursuant to which, variously, logs, documents, items, computer disks, drives and data files and other information were seized from Lemare, and declared the seizures unlawful. I did so myself in March of 2009. So did Mr. Justice Ehrcke in July of 2011 and Mr. Justice Affleck in February of 2012[1] . Mr. Justice Affleck also struck out a civil claim alleging fraud that the Province had commenced against Lemare, on the basis that it was an abuse of process.

9 At this point, there is not much trust left between the parties. Lemare feels persecuted. The Province feels cheated.

10 In the meantime, Lemare went through a successful internal reorganization involving generational change that contributed to the viability of its core business. One cloud on the horizon was, and remains, a potential liability on the guarantee of a $10 million loan used to fund a Retirement Compensation Arrangements Trust (RCA trust) for the former principal shareholder.

11 Then, in the latter part of May 2012, the horizon clouded up considerably. Lemare received a proposal letter from Jason Kruger CA, Audit Supervisor with the Forest Revenue Audit Program (FRAP) of the Income Taxation Branch, Ministry of Finance.

12 This 10-page letter, dated May 23, 2012, supported by some 177 pages of documentation, proposed to adjust the total amount of stumpage payable by Lemare. A second proposal letter dated June 14, 2012, also supported by voluminous documentation, proposed the assessment of a further amount. Both letters proposed, in addition, the assessment of a penalty of 100% of the amounts said to be owing.

13 The sum of the two proposed assessments against Lemare was $4,996,837, plus 100% penalty, plus interest, yielding a total in excess of $12,000,000.

14 In these circumstances, Lemare appeared before me on June 21, 2012, without notice to any party other than its current operating lender, the Toronto-Dominion Bank (TD), asserting that it was insolvent within the meaning of the CCAA and that it required the Act's protection in order to facilitate a restructuring of its business enterprise and the continuation of its ability to carry on business. I granted the order.

The Application to Exclude Evidence

15 The Province's application to set aside the Initial Order was based, as we shall see, principally on the argument that Lemare was not insolvent as at June 21, 2012, so that I had no jurisdiction under the CCAA to make the order.

16 The Province also sought to rely on a number of alternative positions. Among them was the assertion that Lemare had not acted in good faith in its dealings with the Province. The Province filed affidavit material that included two paragraphs and a number of exhibits upon which it wished to rely in support of that assertion. Lemare advised the Province of its objection to the materials in question as soon as they were given copies of the affidavits, and before the affidavits were filed. The Province declined Lemare's invitation to withdraw the assertions.

17 At the hearing on September 6, 2012, I, too, questioned the Province about withdrawing the two paragraphs in question on the ground that they appeared to be of marginal relevance given the principal basis of the Province's application, which was jurisdiction. The Province, however, wished to proceed on the full record. Hence the adjournment.

18 The problem raised by Lemare was this. On July 7, 2011, Ehrcke J. quashed three search warrants and ordered the Province to return all items seized and all copies of such items to Lemare within 14 days, that time being intended to give the Province an opportunity to seize the items lawfully as it had indicated it could.

19 For reasons that are not material, the time was extended until November 18, 2011. As the Province had by then neither re-seized the materials through lawful means nor returned all of them, Lemare returned before Ehrcke J. on March 26, 2012. At that time, Ehrcke J. ordered that his Order of July 7, 2011, be amended by replacing an earlier term with the following:

> The [Province] shall not use the information from the items seized or any copies of such items against Lemare in any manner, including, but not limited to, in any Court proceeding, administrative proceeding, audit or assessment, unless the [Province has] obtained that information lawfully.

20 On February 17, 2012, two representatives of MOF attended at Lemare's office and, pursuant to Ehrcke J.'s order of July 7, 2011, returned five cardboard boxes. At the same time, Mr. Kruger and a colleague from FRAP attended and demanded an inspection of the same five boxes pursuant to sections 142.2 and 142.21(a) of the *Forest Act*, R.S.B.C. 1996, c. 157, asserting that the boxes contained scaling records. Scaling records are among the documents required to be kept by Lemare for audit or inspection, and which a forest revenue official such as Mr. Kruger is entitled to inspect.

21 Mr. Eric Dutcyvich of Lemare advised Mr. Kruger and his colleague that he required a reasonable amount of time to review the contents of the cardboard boxes to determine whether they contained any items that Lemare was required to produce.

22 On March 8, 2012, Mr. Kruger and his colleague returned and again demanded to inspect the five boxes that had been returned on February 17. Mr. Dutcyvich asked them on what basis they maintained that the contents of those boxes were subject to inspection. He deposed that Mr. Kruger and his colleague acknowledged they had reviewed the contents of the boxes. The boxes were not turned over for inspection, but a number of other documents were made available.

23 The impugned paragraphs of Mr. Kruger's affidavit initially read as follows (I ordered the underlined portion to be deleted at the conclusion of the hearing):

> 25. On February 17, 2012, forest revenue officials attended the offices of Lemare and attempted to conduct an inspection under s. 142.21 of the Forest Act <u>of copied items that had been returned by MFLNR; Lemare refused to permit inspection of the returned items</u>. Attached to my Affidavit as **Exhibit "C"** is a true copy of the February 17, 2012 inspection demand letter delivered to Lemare at the time of the inspection.
>
> 26. On March 8, 2012, forest revenue officials again attended the offices of Lemare to perform an inspection <u>of the returned items. Lemare again refused to permit inspection</u>. Attached to my Affidavit as **Exhibit "D"** is a true copy of the March 8, 2012 inspection demand letter delivered to Lemare at the time of the inspection.

24 Lemare took the position that the entirety of those two paragraphs, together with portions of the inspection demand letters marked as Exhibits "C" and "D", and portions of the two proposal letters annexed to Mr. Kruger's affidavits, were inadmissible as contravening the prohibition ordered by Ehrcke J. on March 26, 2012. The two proposal letters had, of course, already been admitted into evidence in support of Lemare's application for the Initial Order.

25 Lemare argued that all of the impugned portions were based on knowledge that Mr. Kruger had only because of his review of the unlawfully seized materials, without which he would not have had any basis for believing that they were subject to seizure. Accordingly, Lemare submitted, although Mr. Kruger was certainly in a position to make a demand for inspection, he could not state that Lemare had failed to comply, because he could only assert a failure to comply on the basis of knowledge he was not entitled to have. Instead, he would have to accept whatever answer Lemare gave to the demand.

26 The Province argued that Mr. Justice Ehrcke's order only prevented its officers from reaching into the box, so to speak, and withdrawing information to use against Lemare. It did not prevent them from knowing that Lemare had information and documents that it ought to have disclosed, yet had failed to do so.

27 The Province conceded that if it used information from the seized boxes to assert non-compliance on the part of Lemare, then it would run afoul of Ehrcke J.'s order. It pointed out, however, that if Lemare's position was correct, then Lemare would be entitled to lie in response to the demand, and the Province would be powerless to do anything about it even though it knew that Lemare's answer was false.

28 I confess to finding the situation rather surreal — one, indeed, that would have excited the admiration of Lewis Carroll. The Province, forced to return copies of documents it seized unlawfully, gives them over only to attempt immediately to seize them again pursuant to its *Forest Act* powers. But those powers entitle it to the production only of certain items; in asserting that the boxes contained such items, it seemed to be relying on information it obtained unlawfully. On the other hand, for Lemare to argue that the Province is accordingly obliged to accept Lemare's denials on their face though knowing them to be untrue, was hardly reassuring.

29 The fact nevertheless remains that a real dispute exists between the parties as to what Lemare is obliged to produce and what it is not. That dispute should be resolved on bases that do not include unlawful seizure.

30 In the circumstances, I concluded that the underlined portions in the two paragraphs in Mr. Kruger's affidavit, as set out above, did indeed depend upon the use of information from the unlawfully seized boxes, and should therefore be redacted. Although the Province submitted that Mr. Kruger had other sources of information on which to base his demand, I did not find that argument persuasive given the affidavit evidence both of Mr. Kruger and Mr. Dutcyvich.

31 Mr. Kruger was certainly entitled to tell me that forest revenue officials attended on February 17 and March 8, 2012, to perform an inspection. I expect he could also have noted that Lemare produced nothing in response to the demand, although it was too late to redraft the paragraphs, and any revision would invite a response. What, in my view, he could not say in the circumstances was that the items he sought to inspect, and which he deposed that Lemare refused to permit him to inspect, were the very items he had just returned. This is because his entitlement to demand to inspect the specific contents of the boxes (as opposed to documents generally) depended upon his knowing their contents. Without that information, Lemare's refusal was of no relevance. Had his affidavit referred generally to a demand to produce documents that the Province sought, rather than the specific contents of the five returned boxes, I would not have found it objectionable.

32 Although some small portions of both the inspection demand letters and the proposal letters also asserted facts that depended upon knowledge of what was in the boxes of unlawfully seized documents, I ruled them admissible in full. I did so on the basis that they were hearsay documents admitted for the purpose of proving that the Province had issued them, and establishing the positions the Province had taken. The Province did not seek to admit them as proof of the truth of their contents.

The Forest Act Scheme

33 Before turning to the two remaining applications, it is helpful to review the applicable provisions of the *Forest Act* under which the Province's claim arises.

34 The Province submits, and I accept, that the *Forest Act* creates a comprehensive code for the calculation, assessment and collection of stumpage in British Columbia. The payment of stumpage is based on a self-reporting system that is subject to compliance reviews and enforcement through audits and assessments.

35 The recovery of money required to be paid under the *Forest Act*, including assessed stumpage, is governed by Part 11, and provides (section 130(1)(b)) that the amount will bear interest, in the case of an assessment for stumpage, from the date determined by the commissioner to be the date that the stumpage would have been due, and (section 130(1)(c)) may be recovered in Court as a debt due to the government.

36 The assessment of stumpage falls under Part 11.1 of the *Forest Act*. Under section 142.51, if it appears to the commissioner, as is alleged here, that some or all of the Crown timber harvested was not reported in the scale, or was reported incorrectly, then the commissioner may make an estimate of the total amount of stumpage owing, and may assess the harvester or persons dealing in the timber harvested for the amount estimated. She may then assess the amount of interest payable on the amount assessed.

37 Under section 142.61, the commissioner may assess a penalty that does not exceed 100% of the assessment if she is satisfied that the assessment is based upon the person's wilful contravention of the Act, or wilful provision of a false or deceptive statement. That was what was proposed here. Where the commissioner is satisfied that an assessment is based upon the person's contravention of the Act that is not wilful, she may assess a penalty that does not exceed 25% of the assessment.

38 The practice of the FRAP, which carries out the assessment, is to provide foresters with an audit proposal letter in advance of the assessment, to which the forester is allowed 30 days to respond. The assessment will then follow. Thus, in this case, the Province provided the proposal letters of May 23 and June 14, 2012. No formal assessments were issued because of the intervention of the Initial Order's stay of proceedings.

39 Once an assessment is issued, then by section 130(1)(d), the amount stated to be owing constitutes a lien in favour of the government against assets and chattels of the person owing the money, and has priority over all unsecured claims.

40 That priority has not accrued to the Province because the stay prevented the proposed claim from becoming an assessment. Both Lemare and TD are anxious that this remain the *status quo* in order to avoid the Province getting a leg up over other unsecured creditors.

41 By section 142.81, evidence that an assessment has been made is proof, in the absence of evidence to the contrary, that the amount assessed is due and owing, and the onus of proving otherwise is on the person liable to pay the amount assessed. The Province places great emphasis on the advantages it stands to gain from this section, particularly given its belief that Lemare has been less than forthright in its disclosure. Moreover, unless varied on appeal, an amount assessed is valid and binding despite any error, defect or omission in the estimate or assessment or in procedure.

42 Section 142.9 provides the person assessed the right to appeal either the assessment or any penalty to the Revenue Minister. An appeal does not operate as a stay. Under section 142.91, the Revenue Minister's decision may be appealed to this Court by way of petition, and the *Supreme Court Civil Rules* relating to petition proceedings apply. The appeal is a hearing *de novo*. Rule 18-3, governing appeals, does not apply.

43 With this context in mind, I turn to consider the Province's application.

The Application to Set Aside the Initial Order

44 With respect to the Initial Order, the Province raises three issues. The first is whether Lemare met the criteria in subsection 3(1) of the CCAA so as to give the Court jurisdiction to proceed under that Act.

45 The second issue, raised in the alternative, is whether the Court should decline to exercise its jurisdiction under the CCAA if that jurisdiction exists.

46 The third is raised in the further alternative: if the Court has and chooses to exercise its CCAA jurisdiction, should it revise the terms of the stay of proceedings in order to permit an assessment to issue under Part 11.1 of the *Forest Act*?

1. Jurisdiction

47 The Province submits that this Court lacked jurisdiction to make the Initial Order because the CCAA does not apply to the petitioners. The Province relies on subsection 3(1):

> **3.** (1) This Act applies in respect of the debtor company or affiliated debtor companies if the total of claims against the debtor company or affiliated debtor companies, determined in accordance with section 20, is more than $5,000,000 or any other amount that is prescribed.

48 On the evidence, there is no doubt that the petitioners are affiliated companies, and that the total of claims against them is more than $5,000,000. The issue, then, is whether they are "debtor companies". The CCAA defines "debtor company" as any company that is "bankrupt or insolvent". As none of the petitioners is bankrupt, the question turns on whether they are insolvent. That word is not defined in the CCAA.

49 On June 21, 2012, I concluded that the test had been met. Since then, further evidence has been filed including an affidavit from a chartered accountant, Terrence MacDonald, and four reports from the monitor. Mr. MacDonald offers the opinion that it cannot be conclusively determined from the financial statements that were before me in June whether the petitioners are insolvent. It follows that the financial statements do not establish that the petitioners are not insolvent. What in my view did and still does establish that they are insolvent is the totality of the evidence. That view is supported by the monitor who has provided four reports and has raised no suggestion that this is not an appropriate

case for relief under the CCAA. On the contrary, the monitor has very much supported the process, and advises that Lemare has set about it in good faith.

50 The Province argues that I cannot rely on the amounts set out in its proposal letters as these were never crystallized as assessments and penalties. Consequently, the Province submits, they cannot be valued even as contingent claims, and the penalties cannot be taken into account at all because they do not qualify even as a contingent obligation until the commissioner exercises her discretion to assess them.

51 In the particular situation before me, I am not persuaded by that argument. These parties have been battling over the issue of stumpage for three years. Their respective positions have become quite clear. The Province's proposals are set out in great detail, together with all of the assumptions upon which they are based, the reasons for the conclusions to which the Province has come, and the facts, assumptions and reasoning for the imposition of penalties. All of this is supported by hundreds of pages of documents annexed to these letters. The penalties are proposed to be assessed at 100% instead of 25% on the basis of Lemare's alleged wilful misconduct. Three years of interaction has yielded no hint of any suggestion that the Province would ever consider softening that position. No such hint emerged from the proceedings before me. An assessment of stumpage and penalties in the amount proposed, on all of the evidence, was not a mere possibility. It was a near certainty.

52 In these circumstances, the suggestion that the proposed amounts of assessed stumpage and penalties do not constitute a valuation of a claim in the absence of an assessment, and therefore do not constitute contingent claims, does not accord with reality. The valuation of the proposed claims could hardly be clearer.

53 In this way, I find the situation is distinguishable from that considered by this Court in *Thow, Re*, 2009 BCSC 1176 (B.C. S.C.), where an administrative penalty issued by the B.C. Securities Commission after bankruptcy, based on the bankrupt's prior conduct, was held not to be a claim provable in bankruptcy. Key to that decision was that the penalty could not have been imposed prior to the bankruptcy because at that time the commission had still to conduct an investigation, hold a hearing, make findings and reach a decision. In this case, however, there had been a lengthy investigation, findings had been made and conclusions drawn. All that was necessary to complete the evolution from proposal to assessment was the formality of issuing it — see, for instance, *Harvey, Re*, 2004 ABQB 773 (Alta. Q.B.), and note also *Air Canada, Re* (2006), 28 C.B.R. (5th) 317 (Ont. S.C.J. [Commercial List]). Although it is true that Lemare had an opportunity to respond to the proposal, the Province had already heard everything Lemare had to say, and was singularly unimpressed.

54 Accordingly, I am satisfied that both the proposed assessed stumpage and the proposed penalties qualify as contingent claims.

55 The question remains as to whether the existence of these contingent claims renders Lemare insolvent. The Province submits that the petitioners do not meet the definition of "insolvent person" in the *Bankruptcy and Insolvency Act*, R.S.C. 1985, c. B-3 (BIA), because at the time of the initial order they were not unable to meet their obligations as they generally became due, and it could not be said that their property if fairly disposed of would not be sufficient to enable payment of all obligations due and accruing due.

56 Although courts have generally had regard to the BIA definition of "insolvent person" when dealing with insolvency under the CCAA, the modern trend is to take into account the different objectives of the CCAA. These address the interests of a broader group of stakeholders, and include a more comprehensive process to preserve the debtor company as a going concern.

57 Thus in *Ted Leroy Trucking Ltd., Re*, 2010 SCC 60, [2010] 3 S.C.R. 379 (S.C.C.) at para. 21, the Supreme Court of Canada described the CCAA regime as a flexible, judicially supervised reorganization process that allows for creative and effective decisions. It noted that with reorganizations becoming increasingly complex:

> [61] ...*CCAA* courts have been called upon to innovate accordingly in exercising their jurisdiction beyond merely staying proceedings against the debtor to allow breathing room for reorganization. They have been asked to sanction measures for which there is no explicit authority in the *CCAA*.
>
> . . .
>
> [70] ... Appropriateness under the *CCAA* is assessed by inquiring whether the order sought advances the policy objectives underlying the *CCAA*. The question is whether the order will usefully further efforts to achieve the remedial purpose of the *CCAA* — avoiding the social and economic losses resulting from liquidation of an insolvent company.

58 In *Stelco Inc., Re* (2004), 48 C.B.R. (4th) 299 (Ont. S.C.J. [Commercial List]); leave to appeal refused: 2004 CarswellOnt 2936 (Ont. C.A.), the Court dealt with a submission, like the Province's here, that the Initial Order should be reversed on the ground that Stelco was not a "debtor company" because it was not "insolvent" as defined by the BIA.

59 Mr. Justice Farley, whose views in this area do not bind me but are entitled to the highest respect, made the following observations, which I have taken the liberty of paraphrasing:

> • *On timing*: the usual problem is leaving the application for an Initial Order too late. CCAA should be implemented at a stage prior to the company's death spiral. Thus objections in the reported cases have been based not on an absence of insolvency, but on the proposed plan being doomed to failure as coming too late. [Paras. 13-15]
>
> • *On stakeholders*: these include not only the company and its creditors, but also its employees and their interest in a viable enterprise. Thus there is an emphasis on operational restructuring so that the emerging company will have the benefit of a long-term viable fix, to the advantage of all stakeholders. [Paras. 17-20]
>
> • *On the test for insolvency*: given the time and steps involved in a reorganization, the condition of insolvency perforce requires an expanded meaning under the CCAA. What the debtor must do is meet the onus of demonstrating with credible evidence on a common sense basis that it is insolvent within the meaning required by the CCAA in the context and within the purpose of that legislation. The BIA definition of insolvent person is acceptable with the caveat that under the first branch (unable to meet obligations as they generally become due), a financially troubled corporation is insolvent if it is reasonably expected to run out of liquidity within reasonable proximity of time as compared with the time reasonably required to implement a restructuring. Considering the notion of 'insolvent' contextually and purposively, the question is whether, at the time of filing, there is a reasonably foreseeable expectation that there is a looming liquidity condition or crisis which will result in the applicant running out of "cash" to pay its debts as they generally become due in the future without the benefit of the stay and ancillary protection and procedure by Court authorization pursuant to a CCAA order. [Paras. 26 and 40]

60 There is, of course, no precise and invariable formula. This is not a "cookie cutter" exercise. As Farley J. pointed out, the matter must be decided on the basis of credible evidence and common sense, employing a principled, purposive and contextual approach.

61 The Province argues that the *Stelco Inc., Re* case is wrongly decided, or in the alternative, that it must be confined to its particular facts which are distinguishable from those before me. I consider it, with respect, to be correctly decided. While the facts are quite different, the principles are not.

62 As I see this case, given the context of Lemare's operations, including the admittedly highly contingent liability for the RCA trust loan, the Province's proposal letters setting forth a fully articulated and documented claim for over $12,000,000 that would, once formalized, lead to statutory lien rights, gave rise to a reasonably foreseeable expectation of a looming liquidity crisis that would deprive Lemare of the ability to pay its debts as they generally became due without the benefit of a stay. Thus this Court had jurisdiction. Having regard to the interests of the stakeholders, including the

Province, other unsecured creditors, Lemare, its employees, and the North Island economy to which Lemare is such a contributor, the situation cries out for the protection of the CCAA. To delay action until Lemare had been fatally wounded would have served the interests of no one.

2. Discretion

63 The careful reader may discern from the preceding paragraph that I do not agree with the Province's alternative submission that if this Court has CCAA jurisdiction it should decline to exercise it.

64 The Province argued first that I should not accept as credible Lemare's plea of insolvency due to the proposed assessments when Lemare has vigorously contested them. Having found that the assessment of stumpage and penalties in the amount proposed was a near certainty, and given the single-mindedness with which the Province has pursued its claims against Lemare, I do not find this argument persuasive. Lemare is entitled to dispute claims, which is one of the reasons that a CCAA Court normally provides for a claims process.

65 The Province then argues that there is no pressing need for Lemare to restructure. I disagree, as indicated above. As counsel for TD points out, the prospect of Lemare obtaining financing to deal with its liability is vanishingly small. Moreover, that the *Forest Act* provides Lemare with appeal rights likely to occupy a good deal of time, first to the Minister and then to this Court, does not relieve the pressure, particularly when those appeals do not stay the claims.

66 The Province submits that its response cannot be known. It may well reduce the claims, or voluntarily stay its claims during the appeal process, or come to some agreement with Lemare about repayment that would relieve these pressures. I do not doubt the sincerity of counsel, but given the history of acrimony between the parties, this is at best speculation. It would be unfair either to expect such accommodation from the Province, or to require Lemare to order its affairs as if it were forthcoming. If the Province should indeed decide to alter its position in a manner that significantly changes Lemare's financial prospects, then that can be taken into account through subsequent applications. The process is a flexible one.

67 The Province next asserts that since its claim is in connection with the harvesting of Crown timber, a public resource, it would be an injustice and contrary to the public interest to thwart the statutory scheme, particularly the commissioner's entitlement to rely on assumptions and place the onus of proof on Lemare.

68 The public interest, I think, cuts both ways. The public certainly has an interest in the Crown recovering stumpage and penalties owed to it. The public also has an interest in seeing enterprises such as these, being major employers and economic contributors, continue in business. I agree with the Province, particularly in view of past dealings between the parties, that in this case both the public interest and fairness support maintaining its statutory advantages concerning the ability to rely upon assumptions, and putting the onus of proof upon Lemare. These, however, may be adequately addressed in the claims process part of this proceeding.

69 The Province then turns to the nature of its dispute with Lemare, relying on its allegation of wilful misconduct. This, it submits, is not appropriate for determination through a CCAA claims process, and relies in particular on subparagraphs 19(2)(c) and (d) of the CCAA:

> **19.** (2) A compromise or arrangement in respect of a debtor company may not deal with any claim that relates to any of the following debts or liabilities unless the compromise or arrangement explicitly provides for the claim's compromise and the creditor in relation to that debt has voted for the acceptance of the compromise or arrangement:
>
> . . .
>
> > (c) any debt or liability arising out of fraud, embezzlement, misappropriation or defalcation while acting in a fiduciary capacity or, in Quebec, as a trustee or an administrator of the property of others;

(d) any debt or liability resulting from obtaining property or services by false pretenses or fraudulent misrepresentation, other than a debt or liability of the Company that arises from an equity claim....

70 These are issues that arise at a later time in this process, when a proposed compromise or arrangement falls to be considered. The Province argues, however, that its penalty claim will be caught by these provisions and therefore, as a matter of discretion, the CCAA process should not be initiated.

71 I am not presently convinced that either subparagraph will prove to be applicable, although I do not decide that issue. It was not fully argued. For present purposes, I do not see this contingency tipping the balance of all of the other factors and interests that must be weighed, and accordingly I decline to refuse CCAA protection because of it.

72 I take the same view of the Province's final point, which is that FRAP proposes to assess portions of the assessments against Lemare against two of its principals, who are also licensees. These total some $563,000. Although no proposal letters have yet been issued in this regard, the Province argues that they give rise to the risk of duplicative proceedings as they will be dealt with under the *Forest Act*, and may lead to inconsistent results.

73 I do not see that the possibility that the Province will proceed in this way alters the balance, with or without the other factors argued by the Province.

74 It follows that, having found that this Court has jurisdiction under the CCAA, I decline as a matter of discretion to refuse to exercise that jurisdiction.

3. The Scope and Effect of the Stay

75 The Province accepts that, pursuant to section 11.02 of the CCAA, a stay can properly prevent the Revenue Minister from taking enforcement action under section 130 of the *Forest Act* in order to collect an amount owing pursuant to an assessment. The Province argues, however, that the exception set out in section 11.1(2) means that it cannot be stayed from making an assessment or taking any steps to obtain information relevant to the proposed assessment.

76 According to section 11.1(2):

(2) Subject to subsection (3), no order made under section 11.02 affects a regulatory body's investigation in respect of the debtor company or an action, suit or proceeding that is taken in respect of the company by or before the regulatory body, other than the enforcement of a payment ordered by the regulatory body or the Court.

77 On the evidence, it is clear that the Province has already carried out its investigation. The only step left was to review any response to the proposal letters forthcoming from Lemare, which Lemare has indicated that it waives, viewing it as an exercise in futility.

78 For the reasons discussed above, I have concluded that the proposed assessments and penalties set out in the proposal letters qualify as contingent claims. They are therefore claims that may be dealt with by a compromise or arrangement under section 19(1), subject to s. 19(2). I further conclude that under the *Forest Act* scheme, in the circumstances of this case, the issuing of an assessment, which gives rise to lien rights and recovery rights, constitutes a step in "the enforcement of a payment ordered by the regulatory body" within the meaning of section 11.1(2) of the CCAA. What we are concerned with here are the financial consequences of past actions, not the regulation of ongoing conduct. See, for instance, *AbitibiBowater Inc., Re*, 2010 QCCS 1261, 68 C.B.R. (5th) 1 (C.S. Que.). If I had concluded otherwise, then the situation would likely have qualified for the exception set out in section 11.1(3).

79 Finally, the Province submits that if the other relief it seeks is denied, it would nevertheless be just and equitable to lift or amend the stay of proceedings in order to permit the commissioner to make an assessment against Lemare, thus crystallizing the claim in relation to both stumpage and penalty. Mr. Hatter assured me that in seeking this, the Province was in no way attempting to gain a priority advantage in relation to other unsecured creditors.

80 I propose to consider this aspect of the matter in relation to Lemare's application for a claims process order.

81 The application to set aside or terminate the Initial Order is dismissed.

The Application for a Claims Process Order

82 Lemare has submitted a CPO in what is a substantially standard form. One portion that departs from standard terms deals with claims by the Province:

> **CROWN CLAIMS**
>
> 29. In the event the Crown wishes to assert a Crown Claim against the Petitioners and/or any Director and/or any Officer, the Crown shall file and serve on the relevant parties an application before the Court prior to the Claims Bar Date setting out the amount of the Crown Claim, the basis therefore and any other information necessary for the Court to determine the Crown Claim ("**Adjudication Application**").
>
> 30. The Petitioners and/or any Directors and/or any Officers, as applicable, shall file and application response to any Adjudication Application within 15 days from the Claims Bar Date.
>
> 31. Any Adjudication Application shall be heard as soon as practicable by the Court, and any party may apply for directions setting a date therefore [*sic*].
>
> 32. If the Crown fails to file a Crown Claim as provided herein, or as the Court may otherwise direct it shall:
>
> > (a) be and is hereby forever barred, stopped and enjoined from asserting or enforcing any Crown Claim against any of the Petitioners and/or any of the Directors and/or Officers and all such Crown Claim(s) shall be forever extinguished;
> >
> > (b) not be permitted to vote on any Plan, if applicable, on account of such Crown Claim(s);
> >
> > (c) not be permitted to participate in any distribution under any Plan from the proceeds of any sale of the Petitioners' assets, or otherwise, on account of such Crown Claim(s); and
> >
> > (d) not be entitled to receive further notice in respect of these CCAA proceedings.
>
> 33. If the Petitioners fail to respond to the Adjudication Application as provided herein, or the Court may otherwise direct, the Crown Claim(s) as set out in the adjudication application shall be Allowed Claims.
>
> 34. The hearing of an Adjudication Application shall be heard as if it were an appeal to the Court under Section 142.9(1) [*sic*] of the *Forest Act*, R.S.B.C. 1996, c. 157, and all onuses or other evidentiary standards contained in the said Act shall apply to the hearing of the Adjudication Application.

83 "Crown Claim" is defined as meaning "any claim of the Crown relating to unpaid stumpage or any other claim pursuant to the *Forest Act...*".

84 I agree with the submissions of Mr. Verbrugge on behalf of the monitor that what I have to consider is whether these sections accomplish the goals of the CCAA with fairness to the Province. This requires a balancing of the need to deal with the Province's claim and all others within the CCAA proceedings to protect everyone equally and allow the company to survive, with the Province's ability to quantify its claim and preserve its advantages concerning the onus of proof.

85 The Province submits that to accomplish this, it is necessary to carve out of the claims process the entire assessment and appeal process from the *Forest Act*. This would contemplate the commissioner making her assessment and assessing a penalty under sections 142.51 and 142.61, Lemare appealing to the Minister under section 142.9, and then appealing

further to this Court by way of petition under section 142.91. Only then would whatever is left of the Province's claim be submitted to the claims process under these CCAA proceedings.

86 With respect, that seems to me to be an enormously cumbersome procedure. It would add very little to the notion of fairness while detracting greatly from an orderly, timely process that preserves the goals of the CCAA. All that the Province really loses by what is proposed in the CPO is the rather time-consuming step of an appeal by Lemare to the Minister. That is no prejudice to the Province. Whether under the CPO or the *Forest Act*, the matter ultimately ends up in this Court. The sooner that happens, the better.

87 I also agree with Mr. Verbrugge that fairness does not require a modification of the stay to permit the Province to proceed to an assessment. It is for the Province to crystallize its claim, as it is for any creditor with a contingent claim. I am satisfied that within the claims process, appropriate provision can be made to facilitate this crystallization in a manner that preserves to the Province the ability to take full advantage of the onus and proof provisions that it would have under the *Forest Act* process.

88 In these circumstances, I am inclined to direct that sections 29 and 34 of the draft CPO be modified so that they read as follows:

> 29. In the event the Crown wishes to assert a Crown Claim against the Petitioners and/or any Director and/or any Officer, the Crown shall file and serve on the relevant parties an application before the Court prior to the Claims Bar Date ("**Adjudication Application**"). The Adjudication Application shall be in the form of an assessment as if made under sections 142.51 through 142.61 of the *Forest Act*, R.S.B.C. 1996, c. 157, and will constitute proof, in the absence of evidence to the contrary, that the amounts assessed are due and owing. The onus of proving otherwise shall be on the Petitioners.
>
> . . .
>
> 34. The hearing of an Adjudication Application shall proceed as if it were an appeal under section 142.9(1) of the *Forest Act*, taken to the Court instead of the revenue minister, directly from assessments made under sections 142.51 through 142.61 of the said *Act* as set out in the Adjudication Application pursuant to section 29 of this Order, and subject to the further direction of the Court.

89 Because this wording was not the subject of any discussion or submissions during the hearing, the parties have leave to return before me for further brief submissions concerning this modification if they find it necessary to do so.

90 There are two other modifications that the Province submits should be made, with which submission I agree. The first is to paragraph 19(a) of the draft CPO, which deals with creditors who do not file a Proof of Claim within the time limited, and goes on to provide that any such person:

> (a) be and is forever barred, stopped and enjoined from asserting or enforcing any Claim against any of the Petitioners and/or any of the Directors and/or Officers and all such Claims shall be forever extinguished.

91 Although this is hardly unusual wording, the Province points out, and I agree, that the extinguishment of claims properly occurs at the later Plan and Sanction Order stage, and should not properly be part of the CPO. What the CPO can properly accomplish is preventing creditors who have not submitted claims in accordance with the process from asserting or enforcing any claim. Accordingly, paragraphs 19(a) and 32(a) should be amended by striking out the words "and all such [Crown] Claims shall be forever extinguished".

92 The Province also objects, properly, to the overly broad definition and treatment of directors and officers. Accordingly the definition of "Directors/Officers Claim" in Schedule "B" to the draft CPO will be amended by deleting the words "or in any other capacity" from the end of the definition. This will limit the definition to claims against directors or officers in their capacity as such.

93 Apart from these modifications, the form of the draft CPO is satisfactory. The stay is extended until November 30, 2012.

94 I remind the parties that the interpretation of the CPO and the administration of the claims process remain subject to the provisions of the CCAA.

Order accordingly.

Footnotes

1 *Lemare Lake Logging Ltd. v. British Columbia (Minister of Forests & Range)*, 2009 BCSC 909 (B.C. S.C. [In Chambers]) and 2009 BCSC 902 (B.C. S.C.); *Lemare Lake Logging Ltd. v. British Columbia (Minister of Forests & Range)*, 2011 BCSC 903 (B.C. S.C.); *British Columbia v. Lemare Lake Logging Ltd.*, 2012 BCSC 193 (B.C. S.C.). See also *Lemare Lake Logging Limited and Arsenault v. Minister of Forests and Range*, unreported, 23 November 2010, B.C. Prov. Ct. Vancouver No. 209979-1.

26

2004 ABQB 773
Alberta Court of Queen's Bench

Harvey, Re

2004 CarswellAlta 1424, 2004 ABQB 773, [2005] A.W.L.D. 159, [2005] A.W.L.D. 7, 373 A.R. 373, 6 C.B.R. (5th) 23

In the Matter of the Bankruptcy of SHAWN ASHLEY JOSEPH HARVEY

Reg. Smart

Heard: April 27, 2004
Judgment: October 27, 2004
Docket: Edmonton Bk03-100688

Counsel: Dan McDicken for Trustee
Robert A.L. Drummond for Creditor

Subject: Insolvency; Income Tax (Federal); Public; Insurance; Estates and Trusts

Headnote

Bankruptcy and insolvency --- Priorities of claims — Claims of Crown — Federal — Income tax, unemployment insurance, and Canada Pension Plan — General principles

H applied for employment insurance benefits in 1999 but did not disclose $10,239 in self-employment business income — H filed assignment in bankruptcy on January 6, 2002 — In August, 2003, Canada Employment Insurance Commission advised H of its decision that H had knowingly made false representations about his self-employment activities — Human Resources and Development Canada ("HRDC") issued demand on H's employer at time when H was not yet discharged as bankrupt — Trustee in bankruptcy applied for declaration that indebtedness of HRDC represented pre-bankruptcy debt and was claim provable in bankruptcy — Application allowed — Claim of HRDC was provable claim under s. 121 of Bankruptcy and Insolvency Act and was subject to stay provisions prescribed by s. 69.3.

Social assistance --- Employment insurance — Overpayment and offences — Overpayment of benefits — Operation of statutes

H applied for employment insurance benefits in 1999 but did not disclose $10,239 in self-employment business income — H filed assignment in bankruptcy on January 6, 2002 — In August, 2003, Canada Employment Insurance Commission advised H of its decision that H had knowingly made false representations about his self-employment activities — Human Resources and Development Canada ("HRDC") issued demand on H's employer at time when H was not yet discharged as bankrupt — Trustee in bankruptcy applied for declaration that indebtedness of HRDC represented pre-bankruptcy debt and was claim provable in bankruptcy — Application allowed — Claim of HRDC was provable claim under s. 121 of Bankruptcy and Insolvency Act and was subject to stay provisions prescribed by s. 69.3.

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Canada (Attorney General) v. Bourassa (Trustee of) (2002), 2002 ABCA 205, 2002 CarswellAlta 1109, [2002] 11 W.W.R. 285, 36 C.B.R. (4th) 181, 219 D.L.R. (4th) 32, 6 Alta. L.R. (4th) 223, 312 A.R. 19, 281 W.A.C. 19 (Alta. C.A.) — referred to

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Minister of National Revenue v. Blais (1983), (sub nom. *St. Louis Textiles Ltd., Re)* 48 C.B.R. (N.S.) 98, 1983 CarswellQue 38 (Que. C.A.) — considered

National Bank of Canada v. Merit Energy Ltd. (2001), 2001 ABQB 583, 2001 CarswellAlta 913, [2001] 10 W.W.R. 305, 28 C.B.R. (4th) 228, 95 Alta. L.R. (3d) 166, 294 A.R. 15 (Alta. Q.B.) — referred to

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s. 57(6) — considered

APPLICATION by trustee in bankruptcy for declaration that debt to Human Resources and Development Canada was provable claim.

***Reg. Smart*:**

Background and Facts

1 The Trustee in Bankruptcy of Shawn Harvey seeks a declaration that the indebtedness of the Bankrupt to Human Resources and Development Canada ("HRDC") represents a pre-bankruptcy debt and is a claim provable in bankruptcy under s. 121 of the Bankruptcy and Insolvency Act, R.S.C. 1985, c. B-3, as amended (BIA). HRDC takes the position that its claim for recovery of an employment insurance overpayment becomes a debt due only when the Canada Employment Insurance Commission ("the Commission") makes the decision under s. 52 of the Employment Insurance Act S.C.. 1996, c.23, as amended ("E.I. Act") ("the Decision Procedure") that a person has received money to which they were not qualified or entitled.

2 The immediate concern of the Trustee arises from the Demand on Third Party issued by HRDC to the Bankrupt's employer at a time when the Bankrupt is not as yet discharged and is obliged pursuant to a Conditional Order of Discharge to make payments. The Bankrupt's employer has withheld the funds demanded by HRDC and placed them in its solicitor's trust account. As a consequence the Bankrupt is incapable of performing his financial obligation under the Conditional Order of Discharge. The Trustee is of the view that such activities by HRDC are improper on the basis that the claim is provable in the bankruptcy and therefore stayed under s. 69(3) of the BIA. Furthermore, he argues such conduct frustrates the administration of the bankruptcy estate.

3 The BIA is binding on Her Majesty in the Right of Canada pursuant to s. 4.1. Neither party raised this as an issue nor would I expect that it would be disputed that HRDC is bound by the provisions of the BIA but it is nonetheless an essential requisite.

4 It is of considerable concern to this Court that the actions of HRDC may in fact frustrate the bankruptcy administration such that the objectives of the BIA cannot be achieved. However, it is also recognized that the Commission is faced with processing in excess of 1.8 million new claims for EI benefits each year (1.87 million new claims in 2002/03, the Canada Employment Insurance Commission, *Employment Insurance 2003 Monitoring and Assessment Report (Ottawa: Human Resources Development Canada, 2004)*). When processing this substantial volume of relatively small claims in a self reporting and voluntary compliance system, the Commission is vulnerable to incorrect, equivocal, incomplete or false statements made by claimants. An effective and efficient administrative system for recovering overpayments including the ability to sidestep the Courts in the first instance is both desirable and justifiable as a matter of public policy.

5 Although not raised by the parties to this application I am also cognizant that if I find that the Commission's claim is provable then it will be discharged by the bankruptcy unless the Commission is able to establish that it falls within one of the exceptions under s. 178(1) of the BIA. This may well necessitate further Court applications to establish exceptions, for example, whether or not benefits were obtained through false pretenses or fraudulent misrepresentation (*Canada (Attorney General) v. Bourassa (Trustee of)* (2002), 2002 ABCA 205, 36 C.B.R. (4th) 181 (Alta. C.A.).

6 Mr. Harvey (Harvey) applied for EI benefits in 1999 and when doing so did not disclose $10,239.00 in self employment business income which was reported on his Income Tax Return with Canada Customs and Revenue Agency. A request made in October, 2002 seeking clarification as to when this income was earned during 1999 was not responded to by Harvey. Harvey assigned into bankruptcy on January 6, 2002. In August, 2003, the Commission advised Harvey (the Bankrupt) of their decision that he had knowingly made false representations about his self employment activities to HRDC and in September, 2003, HRDC forwarded a Notice of Debt to the Bankrupt for EI overpayments.

7 It is the Commission's position that having made its decision and given notice of the debt after the date of the bankruptcy that the claim was not a claim provable in the Bankruptcy Estate. Therefore, they argue, they are not stayed by s. 69.3 of the BIA and are entitled to proceed with their collection efforts. However, if the claim is provable in bankruptcy then its recovery is governed by the BIA and is stayed unless the Trustee is discharged or the Bankruptcy Court allows it to proceed pursuant to s. 69.4 of the BIA. Section 69.3(1) reads as follows:

> Stays of proceedings — Bankruptcies — Subject to subsection (2) and sections 69.4 and 69.5, on the bankruptcy of any debtor, no creditor has any remedy against the debtor or the debtor's property, or shall commence or continue any action, execution or other proceedings, for the recovery of a claim provable in bankruptcy, until the trustee has been discharged.

8 Section 121 of the BIA sets out what claims are provable in Bankruptcy. The two relevant subsections read as follows:

> 121(1) Claims provable — All debts and liabilities, present or future, to which the bankrupt is subject on the day on which the bankrupt becomes bankrupt or to which the bankrupt may become subject before the bankrupt's discharge by reason of any obligation incurred before the day on which the bankrupt becomes bankrupt shall be deemed to be claims provable in proceedings under this Act.
>
> (2) Contingent and unliquidated claims — The determination whether a contingent or unliquidated claim is a provable claim and the valuation of such a claim shall be made in accordance with section 135.

9 The relevant provisions under the E.I. Act are as follows:

> **Liability for overpayment**
>
> 43. A claimant is liable to repay an amount paid by the Commission to the claimant as benefits
>
>> (a) for any period for which the claimant is disqualified; or

(b) to which the claimant is not entitled.

Debts to Crown

47.(1) All amounts payable under section 38, 39, 43, 45 or 46.1 are debts due to Her Majesty and are recoverable in the Federal Court or any other court of competent jurisdiction or in any other manner provided by this Act. (Emphasis mine)

Recovery

(2) If benefits become payable to a claimant, the amount of the indebtedness may be deducted and retained out of the benefits.

Limitation

(3) No amount due under this section may be recovered more than 72 months after the day on which the liability arose.

Appeals

(4) A limitation period established by subsection (3) does not run when there is pending an appeal or other review of a decision establishing the liability.

Reconsideration of claim

52.(1) Notwithstanding section 120, but subject to subsection (5), the Commission may reconsider a claim for benefits within 36 months after the benefits have been paid or would have been payable.

Decision

(2) If the Commission decides that a person

(a) has received money by way of benefits for which the person was not qualified or to which the person was not entitled, or

(b) has not received money for which the person was qualified and to which the person was entitled, the Commission shall calculate the amount of the money and notify the claimant of its decision and the decision is subject to appeal under section 114.

Amount repayable

(3) If the Commission decides that a person has received money by way of benefits for which the person was not qualified or to which the person was not entitled,

(a) the amount calculated is repayable under section 43; and

(b) the day that the Commission notifies the person of the amount is, for the purposes of subsection 47(3), the day on which the liability arises. (Emphasis mine)

Amount payable

(4) If the Commission decides that a person was qualified and entitled to receive money by way of benefits, and the money was not paid, the amount calculated is payable to the claimant.

Extended time to reconsider claim

(5) If, in the opinion of the Commission, a false or misleading statement or representation has been made in connection with a claim, the Commission has 72 months within which to reconsider the claim.

S.C. 1996, c. 23, s. 52, in force June 30, 1996 (Act, s. 190).

Discussion

10 It is necessary to consider the relationship among s. 43, 47 and 52 of the EI Act. Section 43 simply stipulates that the claimant is liable to repay an amount received when not qualified or entitled. Section 47(1) provides that amounts under s. 43 are debts due to Her Majesty and recoverable:

(1) in the Federal Court; or

(2) any other court of competent jurisdiction; or

(3) in any other manner provided by the E.I. Act.

Section 47(3) limits the time for recovery to 72 months after the day on which the liability arose. The question then is how does s. 52 interact with these two sections. Section 52 provides for a process where the Commission may reconsider a claim (the "Decision Procedure") and in the case where benefits are paid when a claimant was not qualified or entitled, prescribes a procedure for notice and recovery including appeals.

Authorities from HRDC

11 Counsel for the Commission has provided a number of authorities but two in particular are pertinent. The first is *Hamel, Re* (2002), 44 C.B.R. (4th) 78 (Que. Bktcy.) (English translation) a decision of Quebec Registrar in Bankruptcy A. Belleau. In that case Hamel assigned into bankruptcy on October 13, 2002 and included in his statement of affairs his "debt" to HRDC. In November 2002, the Commission gave notice that the claimant was to return EI payments arising from false statements made between January 20, 2002 and September 1, 2002. The Trustee argued that the claim arose from false statements made before the bankruptcy and therefore they were provable claims. The Commission argued, as they do in this case, that under ss. 52(3)(b) the liability arises on the day the Commission notifies the person of the amount. The Registrar concluded that the Commission had a provable claim as of the date of the bankruptcy as the "obligation contracted" was in existence on that date. In reaching his decision he refers to a summary of two judgments which read as follows:

In this regard, the undersigned refers the parties to the summary of the following judgments in which the law editor writes:

All debts present or future to which the bankrupt is subject at the date of bankruptcy or to which he may become subject before his discharge by reason of any obligation arising before this date, shall be deemed to be claims provable (ss. 121(1) B.I.A.). The trustee must therefore determine whether a potential and unliquidated claim constitutes a provable claim (s. 135 BIA). There is no real conflict between the *Income Tax Act* and the *Bankruptcy and Insolvency Act*. In fact, an unliquidated claim remains nonetheless a claim. Taxes are due as income is earned. The debt exists even if liability of the debt is postponed.

Quebec (Deputy Minister of Revenue) vs. Leblond, Buzzeni er Associes Ltee. J.E. 2000-872 (C.A.); REJB 2000-17016 (C.A.)

In: re Proposal of Bouvier. Quebec (Deputy Minister of Revenue) vs. Raymond Chabot Inc. (1989) R.J.C. 596 (C.B.); REJB 1989-10857 (C.S.).

12 The second decision is that of the Federal Court of Appeal in *Brière v. Canada (Employment & Immigration Commission)* (1988), [1989] 3 F.C. 88 (Fed. C.A.). In that case Briere had submitted claims for unemployment benefits using a false name and forged documents. The issue was how the prescriptions periods operated under s. 57 of the Unemployment Insurance Act, 1971, S.C. 1970-71-72 c. 48 as.am. (UI Act) (which is the predecessor and substantially the same as s. 52 of the EI Act) and, in particular, issues with respect to the sufficiency of notice. In short, notice was found to be defective and as six years had passed (being the prescribed time by the combined affects of ss. 57(1) and ss. 57(6)) of the UI Act (now ss. 52(1) and ss. 52(5) EI Act) from the time the benefit was paid, it was held that no remedy was available under the UI Act.

13 Justice Lacombe at paragraph 67, pages 23-24, (Quicklaw version) of the judgment states:

> The obligation to repay the overpayment is created by subsection 49(1). However, as appears clearly in subsection 49(4), 57(3) and 57(5), this obligation in fact arises only when the Commission notifies the claimant of the amount that he must repay under s. 49, which it has calculated under subs. 57(1). It is at this point that the debt becomes liquid and payable. If the claimant's obligation to repay arises at that point so, as a corresponding and necessary consequence, does the right of the Commission to recover the debt arise at the same point. The date on which the Commission notifies the claimant of the amount to be repaid determines the starting point of the prescription for recovery of the debt. Accordingly, the obligation to notify, imposed on the Commission by s. 57, and the right to recover, granted to it by s. 49, are necessarily interdependent. In the absence of notification, the claimant has no obligation to repay and the Commission has no right of action. Late notice under s. 57 will have the same effect, of barring and rendering null any remedy exercised under s. 49 of the Act.

14 I agree with the analysis of s. 57 (s. 52 EI Act) that notice must be given within the 36 or 72 month time frame prescribed failing which the Decision Procedure would not be available. However, I do not agree that it is implicit nor that it necessarily follows that the inability to proceed under s. 57 (s. 52) prevents any recovery under the UI Act (EI Act). Furthermore, it was unnecessary to reach that conclusion to deal with the matter, albeit based on the facts of *Brière*, the Commission would have been unable to recover under s. 49 (s.47), regardless. If Justice Lacombe's analysis is correct it is necessary to conclude that Parliament when creating the administrative Decision Procedure intended to preclude all other remedies available to the Commission. Although Parliament has that power, I am reluctant to reach that conclusion unless the provisions in the legislation can be readily interpreted to have that intended affect. It is interesting to note that both Justice Lacombe, notwithstanding his broad-based conclusion and Justice Desjardins in his concurring judgment, ostensibly share a similar reluctance in that they both acknowledge that there may be a common law remedy available and declined to give a declaration that there was nothing owing to the Commission. Justice Marceau in his dissenting judgment was of the view that there is a common law remedy available in addition to those under the EI Act.

15 Section 47 includes the amounts payable under s. 43, among others, as debts due to Her Majesty. It goes on to specifically provide that these debts are recoverable through the Courts or in any other manner provided by the EI Act. Without more, it is apparent that an action for recovery of the debt may be commenced in a Court of competent jurisdiction.

16 Examining ss. 52(3) if the Decision Procedure is followed then a claimant's liability to repay the amount is incorporated into s. 43. If the only liability arising under s. 43 has as its source ss. 52(3) then why incorporate it into s. 43 if its only purpose is to then be incorporated into s. 47. Why not simply incorporate ss. 52(3) directly? In my view ss. 52(3) must be a subset of the broader scope of liability set out in s. 43. To conclude otherwise would mean that s. 43 is redundant.

17 From a practical perspective, in many circumstances where the Commission is barred from proceeding under s. 52, it will also be precluded from proceeding under s. 47. However, if for example, the Commission fails to reconsider a claim and give notice in circumstances where they have only 36 months to do so under s. 52 there would still be the ability to pursue the matter in the Courts for the 72 month period prescribed by s.47. To hold otherwise would make

it necessary to interpret s. 52 as modifying the limitation period set out in ss. 47(3) for all claims arising under s. 43. Certainly with appropriate language this can be achieved but when examining ss. 52(3)(b), it is clear it merely provides for a starting point for the time to run under ss. 47(3) when following the Decision Procedure. The consequential effect of ss. 52(3)(b) is to modify ss. 47(3) to the extent that it applies to the Decision Procedure established under s. 52.

18 In summary s. 52 by its plain language cannot be interpreted as pressed by Counsel for HRDC. Secondly, if it were susceptible to the interpretation argued by HRDC, examining the interaction of the operative sections makes it clear that liability to repay does not exclusively arise under s. 52.

Contingent Claims

19 If s. 52 has the affect pressed by HRDC Counsel, I am nonetheless of the view that the claim is provable. Subsection 121(1) & (2) clearly provide that a contingent or unliquidated claim may be a claim provable in bankruptcy. Even if s. 52 creates a true condition precedent to the claim, it is still a provable claim so long as it is not too remote or speculative in nature (*Confederation Treasury Services Ltd., Re* (1997), 43 C.B.R. (3d) 4 (Ont. C.A.), *National Bank of Canada v. Merit Energy Ltd.* (2001), 28 C.B.R. (4th) 228 (Alta. Q.B.) aff'd [2002] 3 W.W.R. 215 (Alta. C.A.). All of the events which gave rise to the liability to HRDC occurred prior to the bankruptcy. All that need be done by HRDC is to review its file, calculate the amount and give notice. Indeed, in this case it has already been done but in any case it cannot be said that these tasks are so difficult so as to cause one to conclude that the claim is too speculative or remote.

20 Counsel for HRDC relies upon *Minister of National Revenue v. Blais* (1983), 48 C.B.R. (N.S.) 98 (Que. C.A.) in support of the argument that until there is a decision under s. 52 of the EI Act there is no obligation and therefore the claim is not provable in bankruptcy. A wholesaler who was licenced under the Excise Tax Act went bankrupt. At the time of the bankruptcy the bankrupt had on hand goods which it had bought or imported under license. The trial judge declared that the obligation to pay excise tax was a conditional obligation incurred prior to the bankruptcy when the goods were bought or imported by St. Louis and therefore a claim provable in the bankruptcy. The Court of Appeal disagreed as a licenced wholesaler had no obligation, conditional or otherwise, to pay excise tax on goods until it sold them to someone not licenced under the Act or retained them for its own use or for rental to others. As none of these events took place prior to the bankruptcy by operation of law when the licensed Trustee acquired the right to sell the goods it became liable to pay the excise tax. There is simply no analogy to be drawn between the circumstances of this case and those in *Minister of National Revenue v. Blais*.

21 In *Valewood Products Ltd., Re* (1975), 10 O.R. (2d) 672 (Ont. Bktcy.) a company had received a grant from the Crown which was repayable if certain assets ceased to be used for an approved purpose. Upon the happening of the bankruptcy the assets were no longer used for the approved purpose. The Crown was held to have a claim provable in bankruptcy on the basis that the obligation was incurred before the bankruptcy albeit the cessation of use occurred post-bankruptcy. Similarly in this case the obligation arose prior to the bankruptcy and is provable even though it may be interpreted that the liability to repay crystallized under s. 52 subsequent to the bankruptcy.

Decision

22 Based on the above reasons, I conclude that the claim of HRDC is a provable claim under s. 121 of the BIA and therefore is subject to the stay provisions prescribed by s. 69.3 of the BIA. In the circumstances there will be no Order as to costs against HRDC. The Trustee will have his costs out of the estate to the extent that funds are available.

Application allowed.

27

2009 BCSC 1176
British Columbia Supreme Court

Thow, Re

2009 CarswellBC 2293, 2009 BCSC 1176, [2009] B.C.W.L.D. 7083, [2009] B.C.J. No. 1729, 180 A.C.W.S. (3d) 568, 57 C.B.R. (5th) 222

IN BANKRUPTCY AND INSOLVENCY

In the Matter of the Bankruptcy of Ian Gregory Thow

J.S. Sigurdson J.

Heard: June 12, 2009
Judgment: August 28, 2009
Docket: Vancouver B051318

Counsel: R.N. Pelletier, D. Reid for Ian Gregory Thow
W.L. Roberts for British Columbia Securities Commission

Subject: Insolvency; Corporate and Commercial; Securities

Headnote

Bankruptcy and insolvency --- Proving claim — Provable debts — Debts arising after bankruptcy

Bankrupt was mutual fund salesperson who misappropriated millions of dollars of his clients' funds — Bankrupt's employment was terminated and Securities Commission commenced investigation of bankrupt's activities — Bankrupt filed notice of intention to make proposal but proposal was rejected by creditors — Bankrupt was deemed to have made assignment into bankruptcy pursuant to s. 57(a) of Bankruptcy and Insolvency Act ("BIA") — After bankruptcy, Commission found that bankrupt acted contrary to several provisions of Securities Act and ordered him to pay administrative penalty of $6 million which was reduced by Court of Appeal to $250,000 — Commission brought application for declaration that penalty was not provable claim as per s. 121 of BIA and thereby was not subject to s. 69.3 of BIA — Application granted — Commission's decision to impose penalty was discretionary so bankrupt was not liable to Commission until it exercised its discretion — Penalty was not contingent liability or "obligation" under s. 121 of BIA at date of bankruptcy — Penalty was not "obligation" as contemplated by s. 121 of BIA until penalty was assessed by Commission — Obligation did not arise until after bankruptcy and penalty was not provable claim.

Table of Authorities

Cases considered by *J.S. Sigurdson J.*:

Air Canada, Re (2006), 2006 CarswellOnt 8175, 28 C.B.R. (5th) 317 (Ont. S.C.J. [Commercial List]) — followed

British Columbia (Director of Employment Standards) v. Eland Distributors Ltd. (Trustee of) (1996), 40 C.B.R. (3d) 25, [1996] 7 W.W.R. 652, 21 B.C.L.R. (3d) 91, 1996 CarswellBC 527 (B.C. S.C.) — not followed

Chaloux v. Kingston Fairways Golf Course (2004), 2004 CarswellOnt 361, 48 C.B.R. (4th) 237 (Ont. S.C.J.) — followed

Glenister v. Rowe (1999), [1999] 3 All E.R. 452 (Eng. C.A.) — considered

Harvey, Re (2004), (sub nom. *Harvey (Bankrupt), Re)* 373 A.R. 373, 2004 ABQB 773, 2004 CarswellAlta 1424, 6 C.B.R. (5th) 23 (Alta. Q.B.) — distinguished

Strini v. Mihalicz (2006), 2006 ABQB 912, 2006 CarswellAlta 1727, 411 A.R. 202 (Alta. Q.B.) — followed

Thow v. British Columbia (Securities Commission) (2009), 449 W.A.C. 140, 266 B.C.A.C. 140, 307 D.L.R. (4th) 121, [2009] 6 W.W.R. 21, 2009 CarswellBC 294, 2009 BCCA 46, 90 B.C.L.R. (4th) 36 (B.C. C.A.) — referred to

Wosk's Ltd., Re (1985), 1985 CarswellBC 807, 58 C.B.R. (N.S.) 312, [1986] 2 C.T.C. 78, 86 D.T.C. 6243 (B.C. S.C.) — considered

Statutes considered:

Aeronautics Act, R.S.C. 1985, c. A-2
s. 7.7(1) [en. R.S.C. 1985, c. 33 (1st Supp.), s. 1] — referred to

Bankruptcy and Insolvency Act, R.S.C. 1985, c. B-3
Generally — referred to

s. 57(a) — referred to

s. 69.3 [en. 1992, c. 27, s. 36(1)] — referred to

s. 121 — referred to

s. 121(1) — referred to

s. 121(2) — referred to

s. 178 — referred to

s. 178(1)(a) — referred to

s. 178(1)(d) — referred to

s. 178(1)(e) — referred to

Companies' Creditors Arrangement Act, R.S.C. 1985, c. C-36
Generally — referred to

s. 12 — referred to

s. 12(1) — referred to

Employment Insurance Act, S.C. 1996, c. 23
s. 43 — referred to

Securities Act, R.S.B.C. 1996, c. 418
s. 162 — referred to

s. 163 — referred to

Regulations considered:

Aeronautics Act, R.S.C. 1985, c. A-2

Canadian Aviation Regulations, SOR/96-433

Generally — referred to

APPLICATION by Securities Commission for declaration that penalty owing by bankrupt was not provable claim as contemplated by s. 121 of *Bankruptcy and Insolvency Act*.

***J.S. Sigurdson J.*:**

Introduction

1 In this case the bankrupt, after becoming bankrupt, was assessed an administrative penalty by the British Columbia Securities Commission ("BCSC") for his conduct as a mutual fund dealer prior to his bankruptcy.

2 The issues on this application are whether that penalty is a claim provable in his bankruptcy under s. 121(1) of the *Bankruptcy and Insolvency Act*, R.S.C. 1985, c. B-3, ("BIA") and, if so, whether the claim is exempted by s. 178 such that it would not be released by an order of discharge from bankruptcy.

Facts

3 The bankrupt, Ian Gregory Thow (the "Bankrupt"), was employed by Berkshire Investment Group Inc. ("Berkshire") as a mutual fund salesperson. The Bankrupt was also an officer, director, and branch manager with Berkshire.

4 Mr. Thow had hundreds of clients and, through the promotion of securities other than the mutual funds he was registered to sell, he misappropriated millions of dollars of his clients' funds.

5 In June 2005, the Bankrupt was terminated from his employment with Berkshire. At that time, a number of complaints had been made against him by his clients to the BCSC, and the BCSC was in the process of beginning its investigation.

6 On July 22, 2005, the Bankrupt filed a notice of intention to make a proposal. Immediately thereafter, the trustee, Wolridge Mahon Limited, determined that there were a number of companies inextricably linked to the Bankrupt's affairs, and applied in the bankruptcy court to be appointed as interim receiver, then to petition the Bankrupt's companies into bankruptcy.

7 On August 22, 2005, the Bankrupt filed a proposal with the trustee, and, at a meeting of creditors held on September 12, 2005, his proposal was rejected. As such, the Bankrupt was deemed to have made an assignment into bankruptcy pursuant to s. 57(a) of the *BIA*, with the date of bankruptcy being July 22, 2005 (the date of the filing of the notice of intention to file a proposal).

8 On June 29, 2006, the BCSC issued a notice of hearing. That hearing was held on various dates in May, June and July 2007.

9 The evidence before the BCSC included:

(i) Interviews with 26 of the Bankrupt's clients, with their interviews forming part of the record;

(ii) Thirteen of the clients also gave direct testimony at the hearing itself; and

(iii) Evidence by way of expert report from James P. Blatchford Consulting Limited, a forensic accounting firm. Mr. Blatchford's qualifications as an expert included 30 years of forensic accounting, 14 of which were with the RCMP.

10 On October 16, 2007, the BCSC issued its findings and found that Mr. Thow:

(i) failed to deal fairly, honestly and in good faith with his clients, contrary to s. 14(2) of the *Securities Rules* and the rules of the Mutual Fund Dealers Association, when he lied to them and took their money;

(ii) traded in securities without being registered to do so, contrary to s. 34(1)(a) of the *Securities Act*, when, while registered as a mutual fund salesperson, he traded securities that were not mutual funds;

(iii) made representations, contrary to s. 50(1)(d) of the *Securities Act*, when he made untrue statements for material facts about the securities he offered to his clients, and when he omitted material facts about those securities; and

(iv) perpetrated a fraud, contrary to ss. 57(b) and 57.1(b) of the *Securities Act*, when he made misrepresentations to his clients, and used their funds for his own purposes instead of investing them as his clients intended.

11 On December 20, 2007, the BCSC issued its decision in relation to the sanctions (the "Decision"). This decision incorporated by reference the findings noted above.

12 In addition to a number of sanctions prohibiting the Bankrupt from dealing and trading in securities, the BCSC by the Decision ordered the Bankrupt to pay an administrative penalty of $6 million pursuant to s. 162 of the *Securities Act*, R.S.B.C. 1996, c. 418 (the "Penalty").

13 The Decision was registered in the British Columbia Supreme Court, Vancouver Registry, under action No. L080017, on January 7, 2008, and, by virtue of s. 163 of the *Securities Act*, the Decision became an order of the court on that date.

14 Subsequently, the British Columbia Court of Appeal reduced the Penalty to $250,000, based on the statutory provisions in force at the time of Mr. Thow's conduct: *Thow v. British Columbia (Securities Commission)*, 2009 BCCA 46 (B.C. C.A.).

Nature of the Application

15 The BCSC seeks the following orders:

(i) a declaration that the amounts owing by the Bankrupt to the BCSC pursuant to the Decision are not a provable claim as contemplated by s. 121 of the *BIA*, and thus are a post-filing claim and thereby not subject to s. 69.3 of the *BIA*; and

(ii) if it is a provable claim in Mr. Thow's bankruptcy, then, pursuant to s. 178(1)(a), (d), (e) of the *BIA*, the amount owing by the Bankrupt to the BCSC pursuant to the Decision issued by the BCSC on December 20, 2007, is not released by any order of discharge granted to the Bankrupt.

Discussion

16 I will first discuss whether this claim, arising from conduct prior to Mr. Thow's bankruptcy but resulting in a penalty after his bankruptcy, is a claim provable in his bankruptcy.

17 Section 121(1) of the *BIA* provides:

> 121(1) All debts and liabilities, present or future, to which the bankrupt is subject on the day on which the bankrupt becomes bankrupt or to which the bankrupt may become subject before the bankrupt's discharge by reason of any obligation incurred before the day on which the bankrupt becomes bankrupt shall be deemed to be claims provable in proceedings under this Act.
>
> (2) The determination whether a contingent or unliquidated claim is a provable claim and the valuation of such a claim shall be made in accordance with section 135.

18 The Securities Commission argues that its claim was not provable under s. 121(1) of the *BIA* at the date of bankruptcy because the regulatory fine did not become an obligation until it was actually assessed, which was after the date of bankruptcy. It says that the imposition of the fine was a discretionary decision and the obligation of Mr. Thow only arose when the Commission chose to exercise its discretion.

19 The Commission imposed the fine under s. 162 of the *Securities Act*:

> 162 If the commission, after a hearing,
>
> (a) determines that a person has contravened
>
> (i) a provision of this Act or of the regulations, or
>
> (ii) a decision, whether or not the decision has been filed under section 163, and
>
> (b) considers it to be in the public interest to make the order, the commission may order the person to pay the commission an administrative penalty of not more than $1 million for each contravention.

20 On the other hand, Mr. Thow argues that an administrative penalty based on conduct before the bankruptcy is a contingent or unliquidated claim under s. 121(2) and is a claim provable in bankruptcy. His counsel notes that although some claims are so remote and speculative they cannot be considered contingent claims, the potential liability arising out of pending litigation, like this claim by the BCSC, is not one of those types of claims. He says that the date of the impugned conduct is the date giving rise to the Bankrupt's liability to the Commission. His counsel refers to several cases that have found that the fact that a claim does not crystallize until after bankruptcy is immaterial, it is when the obligation arises that is determinative. He argues that the Commission was already investigating Mr. Thow prior to his bankruptcy.

21 Neither party referred to a decided case where the impugned conduct occurred before bankruptcy but the regulatory penalty was imposed by a discretionary decision after bankruptcy.

22 The law is clear that fines imposed after the date of bankruptcy are not provable claims if the fine could not have been imposed until after bankruptcy. For example, in *Wosk's Ltd., Re* (1985), 58 C.B.R. (N.S.) 312 (B.C. S.C.), Cumming J. found that since the fine imposed by Revenue Canada was for the bankrupt's failure to remit taxes, which were due after the bankruptcy, the liability for the penalty did not arise until after bankruptcy and so it was not a provable claim. This is different than the situation in the present case because here both the impugned conduct and the investigation by the Commission into the impugned conduct occurred prior to bankruptcy. Only the hearing and the decision imposing the fine occurred after bankruptcy. Unlike in *Wosk's Ltd., Re*, there is nothing to suggest that the Commission's fine could not have been imposed prior to bankruptcy had the hearings been held earlier and the decision rendered before bankruptcy.

23 Mr. Pelletier, counsel for Mr. Thow, points out that in (*Wosk's Ltd., Re*, Cumming J. held that Revenue Canada did not have a provable claim because the penalty did not arise from anything which preceded the date of proposal. Mr. Thow's counsel argues that to consider the penalty imposed by the BCSC a post-proposal debt would defeat the purpose

of the *BIA*, to permit a debtor to obtain a discharge from all debts and start afresh, and it would allow provinces to create their own priorities under the *BIA*, which is impermissible constitutionally.

24 Both counsel referred to *Air Canada, Re* (2006), 28 C.B.R. (5th) 317 (Ont. S.C.J. [Commercial List]), a case that has relevance to both issues on this application. (*Air Canada, Re* was decided under the *Companies' Creditors Arrangement Act*, R.S.C. 1985, c. C-36, ("*CCAA*") rather than the *BIA*.

25 The question in that case was whether a monetary penalty was a "claim" for the purposes of the *CCAA* and the claims procedure and sanction orders made in that proceeding.

26 The facts briefly were as follows. The Minister of Transport alleged that on December 23, 2000, an Air Canada aircraft landed at Montreal International Airport (Dorval) at 3:41 a.m. in contravention of the noise abatement requirements under the *Canadian Aviation Regulations*, SOR/96-433. On December 19, 2001, the Minister of Transport issued an assessment of monetary penalty against Air Canada under s. 7.7 of the *Aeronautics Act*, R.S.C. 1985, c. A-2., which read:

> 7.7(1) If the Minister believes on reasonable grounds that a person has contravened a designated provision, the Minister may decide to assess a monetary penalty in respect of the alleged contravention, in which case the Minister shall, by personal service or by registered or certified mail sent to the person at their latest known address, notify the person of his or her decision.

27 On April 1, 2003, Air Canada applied for protection from its creditors under the *CCAA*, which resulted, *inter alia*, in an immediate stay of all proceedings. The Court issued a claims procedure order on September 18, 2003, which set forth the process by which creditors' claims would be determined. Paragraph 8 provided that any creditor who did not file a proof of claim before the claims bar date was "... forever barred from making or enforcing any Claim against [Air Canada] and the Claim shall be forever extinguished."

28 The Minister of Transport and Transport Canada did not make a claim in the *CCAA* proceedings even though it had notice of the claims procedure order. The Court issued a sanction order on August 23, 2004, which provided that a creditor who did not file a proof of claim in accordance with the claims procedure is "forever barred from making any Claim against [Air Canada]".

29 Air Canada emerged from *CCAA* protection on September 30, 2004.

30 The first issue was whether the monetary penalty was a claim covered by the claims procedure and sanctions order.

31 "Claim" was defined, in that case, under the claims procedure order as:

> "Claim" means any right of any Person against one or more of the Applicants in connection with any indebtedness, liability or obligation of any kind of one or more of the Applicants owed to such Person and any interest accrued thereon or costs payable in respect thereof, whether liquidated, un-liquidated, fixed, contingent, matured, unmatured, disputed, undisputed, legal, equitable, secured, unsecured, present, future, known or unknown, by guarantee, surety or otherwise, and whether or not such right is executor or anticipatory in nature, including the right or ability of any Person to advance a claim for contribution or indemnity or otherwise with respect to any matter, action, cause or chose in action, whether existing at present or commenced in the future, which indebtedness, liability or obligation is based in whole or in part on facts existing prior to [the date of Air Canada's application for protection under the *CCAA*] or a Restructuring Claim; provided however, that "Claim" shall not include an Excluded Claim.

32 Section 12 of the *CCAA* provides that determinations as to whether any unsecured indebtedness, liability or obligation is a "claim" within the meaning of the *CCAA* are made by reference to the *BIA*. Subsection 12(1) of the *BIA* provides:

> 12.(1) For the purposes of the Act, "claim" means any indebtedness, liability or obligation of any kind that, if unsecured, would be a debt provable in bankruptcy within the meaning of the Bankruptcy and Insolvency Act.

33 The court summarized the position of Air Canada as follows:

> 31 Air Canada submits that the Monetary Penalty is a "claim". It points out that the definition of "claim" in the Claims Procedure Order is broad. It submits that the fact that a claim is contingent, unliquidated or disputed does not change the character of a claim as one provable under the *BIA* so long as the claim is not too remote or speculative. Air Canada submits that given the factual situation at hand, it is clear that a contingent obligation arose on the part of Air Canada prior to the *CCAA* filing and the date of the stay. It submits that liability for the alleged penalty arose on or about December 23, 2000 when the Air Canada plane landed at Montreal's Dorval airport allegedly in contravention of the noise abatement regulations. Finally, Air Canada says the fact that the TATC had not yet upheld the imposition of the Monetary Penalty as of the date of the *CCAA* stay does not change the character of the Monetary Penalty as a claim provable in bankruptcy.
>
> 32 I agree with and accept the submissions of Air Canada. I would only add that while it could be said that Air Canada's liability for the Monetary Penalty first arose on December 23, 2000, in my view that liability only became an "obligation" when the Minister of Transport issued the Monetary Penalty on December 19, 2001. Such a liability is not too remote or speculative and is therefore a provable claim under the *BIA*.

34 Mr. Justice Cumming held that the monetary penalty was a "claim" for the purposes of the *CCAA* and the claims procedure and sanction orders and that the Minister of Transport's right to enforce the monetary penalty was extinguished.

35 The Commission however relies on Cumming J.'s comment at para. 32 that the regulatory penalty in that case did not become an "obligation" until it was actually assessed, rather than becoming an obligation on the date of the impugned conduct. Like the Commission's decision to impose a fine in the case at bar, the fine imposed by the Minister of Transport in *Air Canada, Re* was discretionary.

36 Both parties referred to *Harvey, Re*, 2004 ABQB 773, 373 A.R. 373 (Alta. Q.B.), in which Human Resources and Development Canada ("HRDC") sought repayment from Mr. Harvey of an overpayment of employment insurance. HRDC claimed that it had to be repaid after bankruptcy. However, Registrar Smart held, at para. 19, that since all the events which gave rise to the liability to HRDC occurred prior to bankruptcy, all HRDC had to do was review its file, calculate how much was overpaid, and give notice. The liability for repayment to HRDC was under s. 43 of the *Employment Insurance Act*, S.C. 1996, c. 23:

> 43. A claimant is liable to repay an amount paid by the Commission to the claimant as benefits
>
> (a) for any period for which the claimant is disqualified; or
>
> (b) to which the claimant is not entitled

37 Thus, the bankrupt was liable to the HRDC once he received overpaid benefits; the HRDC did not have to exercise its discretion and demand repayment. Therefore the obligation to pay arose prior to bankruptcy, even though the liability to repay crystallized after bankruptcy.

38 The present case differs from *Harvey, Re*, because here the Commission had to do more than merely review a file and calculate the penalty. The Commission had to undertake an investigation, hold a hearing, make findings and reach a decision. Also, unlike in *Harvey, Re*, in this case the Commission's decision to impose the fine is discretionary.

39 Both parties also referred to *British Columbia (Director of Employment Standards) v. Eland Distributors Ltd. (Trustee of)*, 21 B.C.L.R. (3d) 91, [1996] 7 W.W.R. 652 (B.C. S.C.), which is a similar case to *Harvey, Re*. In *Eland*

Distributors all of the employees were fired after bankruptcy and the issue was whether the Director of Employment Standard's claim for severance pay for employees was a provable claim at the time of bankruptcy. Madam Justice Sinclair-Prowse found that the severance pay claim arose from a contractual obligation the employer had assumed long before the company went bankrupt and said at para. 23 that:

> ...the obligation of the employer to pay severance pay upon the happening of specified events was incurred before the bankruptcy and therefore constitutes a debt or liability to which the employer was subject on the day on which it became bankrupt.

40 The obligation to pay severance arose on the day of bankruptcy automatically by operation of the bankruptcy, because the employees were terminated without cause or notice; there was no exercise of discretion required for the obligation to exist. As a result, I do not think that *Eland Distributors* is applicable to the present case because here there is an exercise of discretion; the Commission's penalty did not automatically follow from the pre-bankruptcy conduct.

41 The position of the Securities Commission is supported by two cases which held that costs, which are at the court's discretion, are not an obligation under s. 121 of the *BIA* until they are awarded: *Chaloux v. Kingston Fairways Golf Course* (2004), 48 C.B.R. (4th) 237 (Ont. S.C.J.); and *Strini v. Mihalicz*, 2006 ABQB 912, 411 A.R. 202 (Alta. Q.B.). In *Chaloux*, the plaintiff in a personal injury case made a voluntary assignment into bankruptcy before the issue of costs in favour of a defendant in the matter could be settled (the action was discontinued against that defendant). The issue was whether the costs were a provable claim under s. 121 of the *BIA*. Likewise, the issue of whether costs are a contingent liability was considered in *Strini*.

42 In both *Chaloux* and *Strini*, the court considered and relied on *Glenister v. Rowe*, [1999] 3 All E.R. 452 (Eng. C.A.), which found that because costs awards are discretionary, they are not a contingent liability under the English equivalent of the *BIA*. In *Chaloux* Belch J. found that *Glenister* is persuasive authority in Canada because the English statute is similar to the *BIA*. In *Glenister*, the English Court of Appeal held that since costs awards are at the discretion of the court, until an order for costs is made there is no "obligation" and there is no liability to pay them and so there is no contingent liability (even if the contingency aspect is there).

43 In *Strini* Kenny J. said this about *Glenister*:

> 27 The essence of the ruling of the English Court of Appeal is that a claim for costs is purely discretionary and comes into existence only when the court makes the order. At the time of bankruptcy there was merely a risk of costs being awarded at a future date. There was no contingent provable liability. Therefore, the Court of Appeal ruled that the costs order did not fall within the bankruptcy.
>
> 28 Applying *Glenister* the court, in *Chaloux v. Kingston Fairways Golf Course*... awarded costs against an undischarged bankrupt. Here the plaintiff was seeking damages for assault. The action did not proceed. The plaintiff declared bankruptcy. After the plaintiff's discharge from bankruptcy, the defendant sought costs. Such were awarded based on the reasoning in *Glenister*.29 I adopt the reasoning in *Glenister*. Costs are a completely discretionary remedy. There is no obligation until there is an order for payment. I am therefore satisfied that any costs I might award would not be provable in bankruptcy and are therefore not released by the discharge granted...

44 In both *Strini* and *Chaloux*, the courts found that since costs are completely discretionary there is no obligation until the court orders payment and so costs awarded after an assignment into bankruptcy are not a provable claim.

45 In my opinion, these cases support the Commission's position. The Commission's decision to impose a penalty was discretionary and so Mr. Thow was not liable to the Commission until it exercised its discretion. Thus the penalty was not a contingent liability or an "obligation" under s. 121 of the *BIA* at the date of his bankruptcy.

46 In my opinion, the *Air Canada, Re* case supports the Commission's position that the penalty is not an obligation as contemplated by s. 121 of the *BIA* until the penalty is assessed by the Commission. Likewise, *Chaloux*, *Strini* and *Glenister* also support the Commission's position that because its decision was discretionary, there was not a contingent liability or "obligation" until the Commission actually fined Mr. Thow, which was after the date of his bankruptcy. Therefore, in my opinion the obligation did not arise until after bankruptcy and the Commission's penalty is not a provable claim in this bankruptcy.

47 Given my conclusion that the penalty imposed by the Securities Commission after the date of bankruptcy is not a claim provable in this bankruptcy, I do not have to go on to decide the next issue, that is, if it was a provable claim, whether it would survive any discharge from bankruptcy.

48 The application of the Securities Commission for a declaration that the Penalty is not a claim provable in Mr. Thow's bankruptcy is allowed.

Application granted.

28

2013 ONSC 2785
Ontario Superior Court of Justice

Jema International Food Products Inc. v. Scholle Canada Ltd.

2013 CarswellOnt 5801, 2013 ONSC 2785, 228 A.C.W.S. (3d) 60, 5 C.B.R. (6th) 273

Jema International Food Products Inc. Plaintiff and Scholle Canada Limited. Defendant

E.M. Morgan J.

Heard: March 6-8, 11, 2013
Judgment: May 13, 2013
Docket: 05-CV-298897PD3

Proceedings: additional reasons to *Jema International Food Products Inc. v. Scholle Canada Ltd.* (2013), [2013] O.J. No. 1776, 2013 CarswellOnt 4515, 2013 ONSC 2270 (Ont. S.C.J.)

Counsel: Nawaz Tahir for Plaintiff
B. Leanne Rapley for Defendant

Subject: Civil Practice and Procedure; Insolvency; Torts

Headnote

Bankruptcy and insolvency --- Practice and procedure in courts — Costs — Miscellaneous

Plaintiff's claim arising from allegedly defective product was dismissed — Defendant's counterclaim was stayed due to plaintiff having made proposal to creditors under Bankruptcy and Insolvency Act (BIA) — Parties made submissions on costs — Defendant awarded costs in amount of $100,000 — To regard stay of proceedings due to proposal under BIA as "success" would be to stretch meaning of word to its breaking point — Plaintiff had not succeeded in anything related to defendant's counterclaim — Virtually no time was spent on preparation or presentation of counterclaim prior to or at trial — There was no reason for stay of counterclaim to be considered to be successful result for plaintiff that somehow equalled defendant's successful result in main claim — There was some limited time spent at trial by both parties on legal submissions as to effect of notice of intention filed by plaintiff and as to applicability of s. 69(1)(a) of BIA — Plaintiff deserved some costs credit for having made BIA argument — There was no liability, contingent or otherwise, by plaintiff to defendant at time of notice of intention to make proposal to creditors, and so no stay of any costs award was to be imposed under s. 69 of BIA — Plaintiff offered to settle for $250,000, and defendant did substantially better than that and so deserved costs on usual partial indemnity scale — Defendant's claim for costs in amount of $118,893.07 was reasonable for action having full discoveries, expert reports, and three-day trial — Defendant's costs were reduced only to give plaintiff some credit for argument of stay of counterclaim.

Civil practice and procedure --- Costs — Effect of success of proceedings — Miscellaneous

Plaintiff's claim arising from allegedly defective product was dismissed — Defendant's counterclaim was stayed due to plaintiff having made proposal to creditors under Bankruptcy and Insolvency Act (BIA) — Parties made submissions on costs — Defendant awarded costs in amount of $100,000.00 — To regard stay of proceedings due to proposal under BIA as "success" would be to stretch meaning of word to its breaking point — Plaintiff had not succeeded in anything related to defendant's counterclaim — Virtually no time was spent on preparation or presentation of counterclaim prior to or at trial — There was no reason for stay of counterclaim to be considered to be successful result for plaintiff that somehow equalled defendant's successful result in main claim — There was some limited time spent at trial by both parties on legal submissions as to effect of notice of intention filed by plaintiff and as to applicability of s. 69(1)(a) of BIA — Plaintiff deserved some costs credit for having made BIA argument — There was no liability, contingent or otherwise, by plaintiff to defendant at time of notice of intention to make proposal to creditors, and so no stay of any costs award was to be imposed under s. 69 of BIA — Plaintiff offered to settle for $250,000, and defendant did substantially better than that and so deserved costs on usual partial indemnity scale — Defendant's claim for costs in amount of $118,893.07 was reasonable for action having full discoveries, expert reports, and three-day trial — Defendant's costs were reduced only to give plaintiff some credit for argument of stay of counterclaim.

Torts --- Negligence — Practice and procedure — Costs — Miscellaneous

Table of Authorities

Cases considered by *E.M. Morgan J.*:

AbitibiBowater Inc., Re (2012), 352 D.L.R. (4th) 399, 71 C.E.L.R. (3d) 1, *(* sub nom. *Newfoundland and Labrador v. AbitibiBowater Inc.)* 438 N.R. 134, 2012 SCC 67, 2012 CarswellQue 12490, 2012 CarswellQue 12491, 95 C.B.R. (5th) 200 (S.C.C.) — followed

Chaloux v. Kingston Fairways Golf Course (2004), 2004 CarswellOnt 361, 48 C.B.R. (4th) 237 (Ont. S.C.J.) — followed

Ross v. Ross Mining Ltd. (2012), 2012 CarswellYukon 128, 2012 YKSC 102, 97 C.B.R. (5th) 241 (Y.T. S.C.) — followed

Statutes considered:

Bankruptcy and Insolvency Act, R.S.C. 1985, c. B-3
Generally — referred to

s. 69 — considered

s. 69(1)(a) — considered

Companies' Creditors Arrangement Act, R.S.C. 1985, c. C-36
Generally — referred to

Rules considered:

Rules of Civil Procedure, R.R.O. 1990, Reg. 194
R. 49 — considered

Words and phrases considered:

success

My judgment dismissing the Plaintiff's claim was rendered on April 17, 2013 [2013 CarswellOnt 4515 (Ont. S.C.J.)].

There was also a counterclaim brought by the Defendant against the Plaintiff. The counterclaim was stayed due to the Plaintiff having made a proposal to creditors under the *Bankruptcy and Insolvency Act*, RSC 1985, c B-3 ("*BIA*").

In his costs submissions, Plaintiff's counsel takes the position that there were mixed results at trial. He argues that while his client did not recover on its claim, the Defendant likewise did not recover on the counterclaim. He therefore submits that there should be no costs awarded to either side.

. . . . .

To call a stay of proceedings due to a proposal under the *BIA* a "success" is to stretch the meaning of the word to its breaking point. The Plaintiff may have "succeeded" in bankrupting itself, but has not succeeded in anything related to the Defendant's counterclaim. Moreover, as indicated, virtually no time was spent on preparation or presentation of the counterclaim prior to or at the trial. There is simply no reason for the stay of the counterclaim to be considered to be a successful result for the Plaintiff that somehow equals the Defendant's successful result in the main claim.

ADDITIONAL REASONS, concerning costs, to judgment reported at *Jema International Food Products Inc. v. Scholle Canada Ltd.* (2013), [2013] O.J. No. 1776, 2013 CarswellOnt 4515, 2013 ONSC 2270 (Ont. S.C.J.) dismissing claim and staying counterclaim.

***E.M. Morgan J.*:**

1 This trial was held over three and a fraction days in March 2013. My judgment dismissing the Plaintiff's claim was rendered on April 17, 2013 [2013 CarswellOnt 4515 (Ont. S.C.J.)].

2 There was also a counterclaim brought by the Defendant against the Plaintiff. The counterclaim was stayed due to the Plaintiff having made a proposal to creditors under the *Bankruptcy and Insolvency Act*, RSC 1985, c B-3 ("*BIA*").

3 In his costs submissions, Plaintiff's counsel takes the position that there were mixed results at trial. He argues that while his client did not recover on its claim, the Defendant likewise did not recover on the counterclaim. He therefore submits that there should be no costs awarded to either side.

4 The Defendant was completely successful in defending against the Plaintiff's action. The pleadings, the documentary disclosure, the examinations for discovery, the trial preparation, and the entire trial were devoted to the Plaintiff's claim and the Defendant's defence of that claim. By contrast, the evidence on the counterclaim consisted of precisely one document (the Defendant's invoice to the Plaintiff) and one minute of testimony when the Defendant's witness introduced and identified this document. No defense to the counterclaim was offered by the Plaintiff.

5 To call a stay of proceedings due to a proposal under the *BIA* a "success" is to stretch the meaning of the word to its breaking point. The Plaintiff may have "succeeded" in bankrupting itself, but has not succeeded in anything related to the Defendant's counterclaim. Moreover, as indicated, virtually no time was spent on preparation or presentation of the counterclaim prior to or at the trial. There is simply no reason for the stay of the counterclaim to be considered to be a successful result for the Plaintiff that somehow equals the Defendant's successful result in the main claim.

6 That said, there was some limited time spent at trial by both parties on legal submissions as to the effect of the Notice of Intention filed by the Plaintiff and as to the applicability of section 69(1)(a) of the *BIA*. The Plaintiff provided me with several authorities demonstrating that the counterclaim is provable in the bankruptcy and therefore subject to a stay, while the Defendant contended that I have discretionary authority to waive the stay. I ruled that the Plaintiff was correct on this point, and that the discretion to waive the stay rests in the bankruptcy court rather than with me as trial judge. Thus, while the stay itself was not the equivalent of a successful defence of the counterclaim, the Plaintiff does deserve some costs credit some for having made the *BIA* argument.

7 The counterclaim was stayed under section 69(1)(a) of the *BIA*, which stays any existing liability or contingent liability against a debtor once the debtor has filed a Notice of Intention to make a proposal to its creditors. In *Chaloux*

v. Kingston Fairways Golf Course (2004), 48 C.B.R. (4th) 237 (Ont. S.C.J.), this court held that a costs award is not a contingent liability of the debtor in light of the discretionary nature of all costs awards in civil proceedings.

8 This logic has recently been analyzed at some length and adopted by the Yukon Supreme Court in *Ross v. Ross Mining Ltd.*, [2012] Y.J. No. 162 (Y.T. S.C.), where it was noted that the refusal to impose a stay under the *BIA* of a costs award against an unsuccessful plaintiff/debtor was consistent with the interpretation of section 69 provided in Houlden, Morawetz and Sarra, *Bankruptcy and Insolvency Law of Canada*, 4th ed., looseleaf (Toronto: Carswell, 2009). The learned authors reasoned that "if no judgment is given against him or her and no order is made for payment of costs until after he or she becomes bankrupt, costs are not a provable debt."

9 The same principle has been applied by the Supreme Court of Canada under the *Companies' Creditors Arrangement Act*, RSC 1985, c C-36, where the court found that in order to qualify for a stay "the debt, liability or obligation must be incurred before the debtor becomes bankrupt." *AbitibiBowater Inc., Re*, 2012 SCC 67 (S.C.C.), at para 26.

10 Applying all this to the present costs question, I conclude that there was no liability — contingent or otherwise — by the Plaintiff to the Defendant at the time of the Notice of Intention to make a proposal to creditors, and so no stay of any costs award is imposed under section 69 of the *BIA*.

11 The Plaintiff submitted an offer to settle prior to trial, but in the result this offer did not afford the Plaintiff any protection under Rule 49 of the *Rules of Civil Procedure*. The Plaintiff offered to dismiss the action in return for payment of an all-inclusive amount of $250,000.00. Needless to say, the Defendant did substantially better than that at trial and so deserves its costs on the usual partial indemnity scale.

12 The Defendant submits a Bill of Costs that sets out fees of $87,902.74, HST of $8,866.72, and disbursements of $22,069.00, for a total of $118,893.07. This is a reasonable claim for costs for an action that had full discoveries, expert reports, and a three day trial. I would reduce the Defendant's costs only to give the Plaintiff some credit for the argument of the stay of the counterclaim.

13 The Plaintiff shall pay the Defendant costs in the total amount of $100,000.00, inclusive of disbursements and HST.

Order accordingly.

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29

2012 YKSC 102
Yukon Territory Supreme Court

Ross v. Ross Mining Ltd.

2012 CarswellYukon 128, 2012 YKSC 102, [2012] Y.J. No. 162, 226 A.C.W.S. (3d) 336, 97 C.B.R. (5th) 241

Norman Ross (Plaintiff) and Ross Mining Limited, Mackenzie Petroleums Ltd. and Golden Hill Ventures Limited Partnership (Defendants)

Golden Hill Ventures Limited Partnership (Petitioner) and Ross Mining Limited, Mackenzie Petroleums Ltd. and Norman Ross (Respondents)

R.S. Veale J.

Judgment: December 17, 2012
Docket: Whitehorse S.C. 09-A0014, S.C. 09-A0087

Counsel: Murray J. Leitch for Norman Ross
Michael Morgan for Golden Hill Ventures Limited Partnership
Jocelyn Barrett for Mackenzie Petroleums Ltd.

Subject: Insolvency; Civil Practice and Procedure

Headnote

Bankruptcy and insolvency --- Proving claim — Provable debts — Miscellaneous

Court costs — Parties entered into loan agreement to finance purchase of respondent's mine — Applicant failed to complete payments under loan agreement and respondent obtained order appointing receiver — Applicant commenced claim of lien action against respondents — Following commencement of claim of lien action, applicant made proposal to unsecured creditors, which was accepted by majority of creditors — Applicants' action against respondents was vacated and discharged and costs were awarded to respondents in $150,000 range, which exceeded security for costs of $75,000 previously ordered — Applicant brought application to determine whether costs were provable claims under s. 121 of Bankruptcy and Insolvency Act and proposal — Court costs awarded to respondents were not provable claims pursuant to s. 121(1) of Act or on actual terms of proposal as they were not contingent or future liability at the date of filing — Costs were payable by applicant outside of proposal — Definition of "claim" in this proposal, which specifically referred to "any indebtedness, liability or obligation of any kind . . . in existence at the Filing Date . . . ", did not capture court costs, which were discretionary and, here, were awarded after the filing date.

Bankruptcy and insolvency --- Practice and procedure in courts — Costs — Miscellaneous

Parties entered into loan agreement to finance purchase of respondent's mine — Applicant failed to complete payments under loan agreement and respondent obtained order appointing receiver — Applicant commenced claim of lien action against respondents — Following commencement of claim of lien action, applicant made proposal to unsecured creditors, which was accepted by majority of creditors — Applicants' action against respondents was vacated and discharged and costs were awarded to respondents in $150,000 range, which exceeded security for costs of $75,000 previously ordered — Applicant brought application to determine whether costs were provable claims under s. 121 of Bankruptcy and Insolvency Act and proposal — Court costs awarded to respondents were not provable claims pursuant to s. 121(1) of Act or on actual terms of proposal as they were not contingent or future liability at the date of filing — Costs were payable by applicant outside of proposal — Definition of "claim" in this proposal, which specifically referred to "any indebtedness, liability or obligation of any kind . . . in existence at the Filing Date . . . ", did not capture court costs, which were discretionary and, here, were awarded after the filing date.

Civil practice and procedure --- Costs — Persons entitled to or liable for costs — Miscellaneous

Parties entered into loan agreement to finance purchase of respondent's mine — Applicant failed to complete payments under loan agreement and respondent obtained order appointing receiver — Applicant commenced claim of lien action against respondents — Following commencement of claim of lien action, applicant made proposal to unsecured creditors, which was accepted by majority of creditors — Applicants' action against respondents was vacated and discharged and costs were awarded to respondents in $150,000 range, which exceeded security for costs of $75,000 previously ordered — Applicant brought application to determine whether costs were provable claims under s. 121 of Bankruptcy and Insolvency Act and proposal — Court costs awarded to respondents were not provable claims pursuant to s. 121(1) of Act or on actual terms of proposal as they were not contingent or future liability at the date of filing — Costs were payable by applicant outside of proposal — Definition of "claim" in this proposal, which specifically referred to "any indebtedness, liability or obligation of any kind . . . in existence at the Filing Date . . . ", did not capture court costs, which were discretionary and, here, were awarded after the filing date.

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Chaloux v. Kingston Fairways Golf Course (2004), 2004 CarswellOnt 361, 48 C.B.R. (4th) 237 (Ont. S.C.J.) — considered

Custom Iron & Machinery Ltd. v. Calorific Construction Ltd. (1996), 1996 CarswellOnt 4812, 45 C.B.R. (3d) 279 (Ont. Gen. Div.) — followed

Employers' Liability Assurance Corp. v. Ideal Petroleum (1959) Ltd. (1976), 1976 CarswellQue 32, [1978] 1 S.C.R. 230, 26 C.B.R. (N.S.) 84, 75 D.L.R. (3d) 63, (sub nom. *Employers' Liability Assurance Corp. v. Ideal Petroleum (1969) Ltd.)* 14 N.R. 503, 1976 CarswellQue 25 (S.C.C.) — referred to

Flint v. Bernard (1888), 22 Q.B.D. 90 (Eng. C.A.) — considered

Glenister v. Rowe (1999), [1999] 3 All E.R. 452, [1999] EWCA Civ 1221, [2000] Ch. 76 (Eng. C.A.) — considered

Romfo v. 1216393 Ontario Inc. (2008), [2008] 8 W.W.R. 112, 69 R.P.R. (4th) 163, 80 B.C.L.R. (4th) 267, 292 D.L.R. (4th) 692, 56 C.P.C. (6th) 1, 2008 BCCA 179, 2008 CarswellBC 840, 42 B.L.R. (4th) 30, 254 B.C.A.C. 281, 426 W.A.C. 281 (B.C. C.A.) — considered

Ross v. Ross Mining Ltd. (2011), 2011 CarswellYukon 26, 2011 YKSC 30 (Y.T. S.C.) — considered

Ross v. Ross Mining Ltd. (2011), 2011 YKSC 91, 2011 CarswellYukon 122 (Y.T. S.C.) — considered

Ross v. Ross Mining Ltd. (2012), 2012 YKSC 18, 2012 CarswellYukon 14 (Y.T. S.C.) — referred to

Ross v. Ross Mining Ltd. (2012), 2012 YKCA 8, 2012 CarswellYukon 64, 325 B.C.A.C. 64, 553 W.A.C. 64 (Y.T. C.A.) — considered

Safire Infrastructure Inc., Re (2009), 2009 CarswellOnt 7440, 61 C.B.R. (5th) 225 (Ont. S.C.J.) — considered

Strini v. Mihalicz (2006), 2006 ABQB 912, 2006 CarswellAlta 1727, 411 A.R. 202 (Alta. Q.B.) — considered

Thow, Re (2009), 2009 BCSC 1176, 2009 CarswellBC 2293, 57 C.B.R. (5th) 222 (B.C. S.C.) — considered

Statutes considered:

Bankruptcy and Insolvency Act, R.S.C. 1985, c. B-3
Generally — referred to

s. 2 "claim provable in bankruptcy" — considered

s. 50(1.2) [en. 1992, c. 27, s. 18] — considered

s. 50(1.6) [en. 1992, c. 27, s. 18(1)] — considered

s. 50.4 [en. 1992, c. 27, s. 19] — referred to

s. 62(2.1) [en. 2005, c. 47, s. 41(2)] — considered

s. 62(3) — considered

s. 121 — considered

s. 121(1) — considered

ss. 124-126 — referred to

s. 178(1) — considered

s. 178(2) — considered

Miners Lien Act, R.S.Y. 2002, c. 151
Generally — referred to

Rules considered:

Rules of Court, O.I.C. 2009/65
R. 26 — considered

R. 26(1) — considered

App. B, s. 2(b)(ii) — referred to

App. B, s. 2(b)(iii) — referred to

APPLICATION to determine whether costs were provable claims under s. 121 of *Bankruptcy and Insolvency Act* and proposal.

***R.S. Veale J.*:**

Introduction

1 Costs have been awarded to Norman Ross and Mackenzie Petroleums Ltd. following the decision in this matter cited as 2012 YKSC 18 (Y.T. S.C.). The issue for this application is whether those costs, which exceed the security for costs of $75,000 previously ordered, are provable claims under s. 121 of the *Bankruptcy and Insolvency Act*, R.S.C. 1985, c B-3, ("the *BIA*") and the amended proposal ("the Proposal") of Golden Hill Venture Limited Partnership ("Golden Hill") approved by the Court. If they are not provable claims, they are payable by Golden Hill outside theProposal. The Court will also consider the effect of Mr. Ross' participation in the Proposal.

Background

2 Norman Ross operated a gold mine on Dominion Creek near Dawson City from 1979 until he sold it to a company owned by Jon Rudolph in 2005. Mr. Rudolph entered into a Loan Agreement with Norman Ross to finance the mine purchase and operated the mine under the name of Ross Mining Limited.

3 On July 29, 2009, Norman Ross obtained an Order appointing PricewaterhouseCoopers LLP as the receiver of the mine as a result of the failure to complete payments under the Loan Agreement.

4 On August 27, 2009, and by amendment on October 20, 2009, Golden Hill, a company also owned by Jon Rudolph, commenced a claim of lien action under the Yukon *Miners Lien Act*, R.S.Y. 2002, c. 151, for a claim totalling $6,790,456.29 against Ross Mining Limited, the mine under receivership. The Golden Hill lien claim was eventually reduced to $2,810,627.08 on December 16, 2009.

5 On November 25, 2009 ("the Filing Date"), Golden Hill filed a Notice of Intention to Make a Proposal pursuant to s. 50.4 of the *BIA*.

6 On January 27, 2010, a Consent Order granted security for costs in the amount of $55,000 to Norman Ross payable by Golden Hill.

7 The Golden Hill Proposal was made to the unsecured creditors of Golden Hill on March 1, 2010, and the Proposalwas accepted by the required majority of creditors on March 22, 2010.

8 This Court approved the Proposal on March 25, 2010. The Proposal contained a specific reference to the claim of lien action in para. 2.5:

> Ross Mining Limited is currently in receivership, and the receiver of that company has undertaken a sale process with respect to the Ross Mine property and assets. GHVLP [Golden Hill] believes that it can sustain its claim in the Miner's Lien Action and establish priority over other creditors of Ross Mining Limited (by virtue of GHVLP's miner's lien). Accordingly, GHVLP anticipates some recovery in the Miner's Lien Action, although at this time it cannot predict what that recovery, if any, might be.

9 The Proposal contained the following definition of "Claim":

> <u>"Claim" means any right of any Person against a Debtor in connection with any indebtedness, liability or obligation of any kind for a Debtor which indebtedness, liability or obligation was in existence at the Filing Date</u>, whether or not reduced to judgment, liquidated, unliquidated, fixed, contingent, matured, unmatured, disputed, undisputed, legal, equitable, secured, unsecured, <u>present, future, known, unknown</u>, by guarantee, indemnity, surety or otherwise and whether or not such a right is executory in nature, including, without limitation, the right or ability of any Person to advance a claim for contribution or indemnity or otherwise with respect to any matter, action, cause or

> chose in action whether existing at present or commenced in the future <u>based in whole or in part on facts which existed prior to or on the Filing Date</u>; (emphasis added)

10 Norman Ross filed a Proof of Claim in the Golden Hill Proposal which included the following:

> Third, pursuant to GHVLP's proceeding commenced in Yukon Supreme Court under number 09-A0087, GHVLP is contingently liable to Mr. Ross for costs if awarded in that proceeding.

11 Mr. Ross estimatedhis costs to be $100,000. The Proof of Claim was dated March 19, 2010, and was accompanied by a Voting Letter voting against the acceptance of the Proposal.

12 The cover letter of Mr. Ross' counsel described "... Mr. Norman Ross, [as] an unsecured creditor of GHVLP based on the definition of "claim" and "creditor" contained in the Proposal."

13 Norman Ross applied for an increase in the security for costs in March 2011. In *Ross v. Ross Mining Ltd.*, 2011 YKSC 30 (Y.T. S.C.), I ordered that the security for costs be increased to $75,000. The Reasons for Judgment include the following:

> [5] Counsel for Norman Ross says that at the time of the Consent Order it was uncertain that the matter would proceed because GHV was in the process of submitting a proposal whose acceptance was not guaranteed. At that time, GHV was admittedly insolvent.
>
> [6] The proposal was approved by the creditors of GHV on March 22, 2010 and this Court on March 25, 2010. GHV maintains that it is still operating but it has no revenue during the winter months. There has been no disclosure of GHV's finances, contracts or future business and no statement that it can pay court costs.

14 In its submission to this Court for special or increased costs, counsel for Norman Ross submitted at para. 39:

> Second, on December 4, 2009, GHVLP filed and served the Affidavit of K. Carruthers #1 giving notice that on November 25, 2009 GHVLP had commenced proposal proceedings under the *Bankruptcy and Insolvency Act*, which proposal was later accepted by GHVLP's creditors and approved by this Honourable Court which effectively insulated GHVLP from: (a) any costs award not protected by security for costs, and (b) any damage award for slander of title.

15 On December 6, 2011, this Court vacated and discharged Golden Hill's claim of lien in Reasons for Judgment cited as *Ross v. Ross Mining Ltd.*, 2011 YKSC 91 (Y.T. S.C.). The trial judgment was upheld on appeal: see 2012 YKCA 8 (Y.T. C.A.).

16 On March 15, 2012, this Court ordered costs paid to Norman Ross against Golden Hill on Scale C with a 1.5 times increase and costs on Scale B to Mackenzie Petroleums Ltd. in 2012 YKSC 18 (Y.T. S.C.). The costs of Norman Ross will be in the $150,000 range.

17 Mackenzie Petroleums Ltd. was not a party to Golden Hill's claim of lien action when the Golden Hill Proposal was filedon November 25, 2009. It was added as a defendant to Golden Hill's lien action on January 27, 2010.

18 Mackenzie Petroleums Ltd. did not file a proof of claim or a Voting Letter in the Proposal.

Issues

19 There are two issues to determine:

> 1 Are awards of court costs "claims provable" under s. 121 of the *BIA*, and is that definition relevant inthe context of a proposal?

2 Should the revised Bill of Costs be reduced?

Analysis

Issue # 1: Are awards of court costs "claims provable" under s. 121 of the BIA, and is that definition relevant in thecontext of a proposal?

20 Section 121(1) of the *BIA* describes "claims provable" as follows:

> All debts and liabilities, present or future, to which the bankrupt is subject on the day on which the bankrupt becomes bankrupt or to which the bankrupt may become subject before the bankrupt's discharge by reason of any obligation incurred before the day on which the bankrupt becomes bankrupt shall be deemed to be claims provable in proceedings under this Act.

21 In s. 2, the definition of claim provable is as follows:

> "claim provable in bankruptcy", "provable claim" or "claim provable" includes any claim or liability provable in proceedings under this Act by a creditor;

22 I am proceeding on the basis that s. 121(1) of the *BIA* applies to a proposal despite the fact that s. 121(1) refers to "the bankrupt" rather than the debtor or insolvent person.

23 The primary distinction between a proposal and a bankruptcy is that a proposal permits the debtor to retain his assets and use them to pay off the terms of the proposal (see *Employers' Liability Assurance Corp. v. Ideal Petroleum (1959) Ltd.* (1976), [1978] 1 S.C.R. 230 (S.C.C.), at p. 239). However, with respect to creditors, the procedure is very similar to a bankruptcy. Section 50(1.2) of the *BIA* requires that the proposal be made to "the creditors generally." Section 50(1.6) of the *BIA* states that "...any creditor may respond to the proposal as made to the creditors generally, by filing with the trustee a proof of claim in the manner provided for in (a) sections 124 to 126, in the case of unsecured creditors; ..."

24 Sections 124 - 126 of the *BIA* are under the subheading"Proof of Claims" which follows and necessarily relates back to the subheading "Claims Provable", beginning at s. 121(1). These sections refer to "the bankrupt" and "bankruptcy", but in my view necessarily must be read to include "debtor" to make the proposal framework in the *BIA* workable. The fact that the definition section of the *BIA* defines "claims provable" to include "any claim or liability in any proceedings under [the *BIA*] by a creditor" supports the interpretation that s. 121(1) of the *BIA* applies to a proposal.

25 In terms of whether court costs are provable claims, counsel provided me with a line of cases that derive from the UK bankruptcy case of *Glenister v. Rowe* (1999), [2000] Ch. 76, [1999] EWCA Civ 1221 (Eng. C.A.). In *Glenister*, it was common ground that if court costs are a"contingent liability" they are a "bankruptcy debt" and the discharge of the bankruptcy would release the bankrupt from the debt. The corollary is that court costs incurred after the date of bankruptcy are not a contingent liability at the date of the bankruptcy. In concluding that the costs in question were not a contingent liability on the date of the bankruptcy and therefore payable by the discharged bankrupt, the Court of Appeal gave the following reasons at p. 84:

> 1. Costs of legal proceedings are in the discretion of the court. Until an order for payment of costs is made there is no obligation or liability to pay them and there is no right to recover them.

26 The Court went on to say that an "order for costs is a "contingency" which may or may not happen ...". It concluded that no liability can arise simply by reason of a claim for costs made in a court proceeding. Simply put, the court concluded that, because of the discretionary nature of an award of court costs, there is no liability, contingent or otherwise, until an order is made.

27 As indicated, this authority has been followed by numerous decisions in Canada.

28 In *Chaloux v. Kingston Fairways Golf Course* (2004), 48 C.B.R. (4th) 237 (Ont. S.C.J.), the bankrupt sued for personal injury and filed a voluntary assignment into bankruptcy before the issue of court costs was resolved. The court costs issue was addressed after the discharge of the bankrupt and Belch J. ruled that:

1. Compensation for personal injury did not vest in the trustee in bankruptcy; and

2. Court costs incurred after the discharge of the bankrupt were not extinguished by the assignment.

29 Belch J. relied upon the principle from *Glenister* and agreed that the discretionary nature of all costs awards in civil proceedings removed them from being contingent liabilities under the *BIA* based upon the similarity between s. 121(1) of the *BIA* and the English statute. As a result, court costs were ordered against the discharged bankrupt.

30 In *Strini v. Mihalicz*, 2006 ABQB 912 (Alta. Q.B.), Mr. Strini applied for court costs arising out of a custody dispute in which he was successful against Ms. Mihalicz, who had made an assignment in bankruptcy in January 2004 and been discharged in December 2004. Kenny J. followed the reasoning in *Glenister* and *Chaloux* and concluded that court costs were not provable in bankruptcy and could be ordered against the discharged bankrupt, adding that, as a matter of policy, a discharged bankrupt should not be able to continue to litigate with impunity after a discharge from bankruptcy.

31 In *Thow, Re*, 2009 BCSC 1176 (B.C. S.C.), the issue was whether an administrative penalty assessed by the British Columbia Securities Commission (BCSC) is a claim provable under s. 121(1) of the *BIA*. Mr. Thow filed a notice of intention to make a proposal on July 22, 2005, which was rejected by the creditors on August 22, 2005, and thus deemed to have been an assignment in bankruptcy on the July 22 date. The BCSC issued a notice of hearing on June 29, 2006, and assessed its administrative penalty on December 20, 2007. Sigurdson J. followed the *Strini* and *Chaloux* decisions and concluded that the decision to impose a penalty was discretionary and not an obligation or contingent liability under s. 121 of the *BIA* until the discretion was exercised, and therefore not a provable claim.

32 In *Safire Infrastructure Inc., Re* (2009), 61 C.B.R. (5th) 225 (Ont. S.C.J.) the issue was whether the costs disposition in litigation directly relating to the bankruptcy itself would survive the bankruptcy on the basis of the*Glenister* principle that court costs were not claims provable pursuant to s. 121(1) of the *BIA* and therefore not released by the discharge granted. Hoy J., as she then was, concluded that the costs award survives the discharge and added that the costs were in the bankruptcy proceeding itself and not with respect to an obligation incurred or a proceeding commenced before the bankruptcy.

33 I note that the cases just cited are consistent with the "Claims Provable"commentary in Houlden, Morawetz and Sarra,*Bankruptcy and Insolvency Law of Canada*, 4th ed., looseleaf (Toronto: Carswell, 2009):

> (b) Defendant's Costs
>
> If an unsuccessful action is brought by a debtor and he or she is ordered to pay costs or if a judgment is given against him or her before he or she becomes bankrupt, the costs are a provable claim. <u>On the other hand, if no judgment is given against him or her and no order is made for payment of costs until after he or she becomes bankrupt, costs are not a provable debt</u>. In such a case, there is no provable debt to which the costs are incident and there is no liability to pay by reason of any obligation incurred by the bankrupt before bankruptcy, nor are the costs a contingent liability to which the debtor can be said to be subject at the date of his or her bankruptcy: *Re British Gold Fields of West Africa Ltd.*,[[1899] 2 Ch 7]. (emphasis added)

34 The recent Supreme Court of Canada decision in *AbitibiBowater Inc., Re*, 2012 SCC 67 (S.C.C.), confirms this principle, albeit in a different context. In that case, a Companies' Creditors Arrangement Act Court judge concluded that the filing of a claim by the Environmental Protection Agency before the date of bankruptcy should be pursued as

a provable claim. This conclusion was upheld by the Supreme Court of Canada. The general principles were set out in para. 26 of that judgment as follows:

> These provisions highlight three requirements that are relevant to the case at bar. First, there must be a debt, a liability or an obligation to a *creditor*. Second, the debt, liability or obligation must be incurred *before the debtor becomes bankrupt*. Third, it must be possible to attach a *monetary value* to the debt, liability or obligation. ...

35 In my view, the test described in*AbitibiBowater Inc., Re* case is similar to what has been outlined in caselaw considering s. 121(1) of the *BIA*.

36 The authority relied on by counsel for Golden Hill is found in *Custom Iron & Machinery Ltd. v. Calorific Construction Ltd.* (1996), 45 C.B.R. (3d) 279 (Ont. Gen. Div.)), where court costs were determined to be a "provable claim" in a proposal.

37 The facts of *Custom Iron* are as follows. On June 22, 1993, Calorific filed a proposal under the *BIA* offering unsecured creditors thirty cents on the dollar. Calorific continued to operate its business under the proposal until May 29, 1995, when the final payout was made by the Trustee. Calorific (I assume prior to the filing date of the Proposal) acknowledged that it owed a 1983 debt to Custom and consented to judgment in the amount of $29,050.29 plus costs, but the parties agreed that Custom would not move on the judgment until Calorific's counterclaim was dealt with. The trial judge awarded Calorific damages on the counterclaim that offset the judgment for Custom.

38 However, on June 1 and 3, 1994, the Ontario Court of Appeal set aside the counterclaim judgment and ordered that Calorific pay the court costs of Custom at trial and on appeal. The issue was whether the 1983 judgment and costs were a claim provable in the proposal.

39 Marshall J. followed *Flint v. Bernard* (1888), 22 Q.B.D. 90 (Eng. C.A.), and applied s. 121(1) and s. 178(2) of the *BIA*(the latter section discharges the debtor from all claims provable in bankruptcy). The specific ratio of Marshall J. is set out at para. 19:

> In the court's view this claim though future and one to which the debtor may have and indeed did become subject was a provable claim under the proposal. In the result, since the claim was provable Calorific, once the proposal was finalized, was released from all its debts then provable.

40 It is important to note that Marshall J. appears to have lumped together the 1983 judgment and costs with the costs on the counterclaim trial and appeal. While the 1983 judgment and costs would have been a provable claim as an existing debt at the effective date of the proposal, the same cannot be said for the award and costs in the counterclaim.

41 Counsel for Golden Hill submits that the *Custom Iron* case is authority for treating a proposal differently than a bankruptcy, and says that the court costs in the case at bar should be considered to be claims provable.

42 I do not agree. The *Custom Iron* case does not create a different principle for proposals under the *BIA.* Rather, it addressed a judgment for a specific sum plus court costs, which pre-dated the date of the proposal and would have clearly been a claim provable. Thus, the court award of costs in the consent judgment made before the proposal was never contingent and was always a liability. It was a discretion exercised and not a contingent claim that might never be realized. To the extent that *Custom Iron*purports to be authority for the principle that court costs ordered after the filing date or acceptance of a proposal areclaims provable, I decline to follow it.

43 I prefer the line of cases that suggest a claim for costs arising after the filing date of a proposal is not a claim provable in the proposal. I do not agree that a proposal should be treated any differently than a bankruptcy with respect to a claim for costs. A claim for costs is not a liability in either case.

44 I am supported by ss. 62(2.1) and (3) of the *BIA*, which provide for when an insolvent person in a proposal, i.e. the debtor, is released as follows:

When insolvent person is released from debt

(2.1) A proposal accepted by the creditors and approved by the court does not release the insolvent person from any particular debt or liability referred to in subsection 178(1) unless the proposal explicitly provides for the compromise of that debt or liability and the creditor in relation to that debt or liability voted for the acceptance of the proposal.

Certain persons not released

(3) The acceptance of a proposal by a creditor does not release any person who would not be released under this Act by the discharge of the debtor.

45 Section 178(1) sets out a list of debts that are not released by the discharge of a bankrupt. Again, while s. 178(1) is not applicable on the facts of the case at bar, it does seem to confirm that provable claims in proposals are treated the same as provable claims in bankruptcy.

46 I am also of the view that the definition of "Claim" in this Proposal, which specifically refers to "any indebtedness, liability or obligation of any kind ... in existence at the Filing Date ...", does not capture court costs, which are discretionary and, here, were awarded after the Filing Date. The court costs in this case were not an obligation or a liability until well after the Filing Date of the Proposal on November 25, 2009.

47 I conclude that the court costs awarded to Norman Ross and Mackenzie Petroleum Ltd. are not provable claims pursuant to s. 121(1) of the *BIA* or on the actual terms of the Proposal.

48 Before leaving this point, I should address the contention of Golden Hill that the fact that Norman Ross indicated in his proof of claim that Golden Hill was "contingently liable" for costs and participated by voting against the Proposal was, in effect, an admission that the claim for court costs was a provable claim in the Proposal. While it may have been wiser for counsel for Norman Ross to describe the claim as being without prejudice to a determination by the court, it does not enhance the submissions of Golden Hill. Theclaim for court costs is not a provable claim in law. It is not inappropriate to file a claim to protect a client's position depending upon the outcome at law.

Issue # 2: Should the revised Bill of Costs be reduced?

49 There were several items in dispute which I shall deal with summarily.

50 Counsel for Golden Hill objects to the claimed disbursement for transcripts in the amount of $5,900 based upon the principle in *Romfo v. 1216393 Ontario Inc.*, 2008 BCCA 179 (B.C. C.A.), that transcript costs are rarely claimed on a bill of costs unless there is a particular controversy over what a particular witness said. The expense of $5,900 is not a real-time reporting expense but it is somewhat excessive for the circumstances of this case and I reduce that amount to $2,500, as some references were made to the transcript.

51 Counsel for Golden Hill objected to the duplication of tariff items as there was really only Golden Hill's claim in issue and Mr. Ross has his costs in this foreclosure action on the mine. I agree and order that the duplication of tariff items be deleted.

52 Counsel for Golden Hill also takes exception to the claim for the maximum allowable units. In the context of the corporate complexity of Golden Hill's indebtedness and financial records, I find the claim for maximum units appropriate.

53 The separate claims under Rule 26 and 26.1 are appropriate.

Conclusion

54 To summarize, I have concluded that the costs awarded against Golden Hill in its claim of lien action are not provable claims under s. 121(1) of the *BIA* or the Proposal as they were not a contingent or future liability at the date of filing.

55 Costs for this application may be spoken to in Case Management, if necessary.

Order accordingly.

30

1993 CarswellOnt 183
Ontario Court of Justice (General Division — Commercial List)

Lehndorff General Partner Ltd., Re

1993 CarswellOnt 183, [1993] O.J. No. 14, 17 C.B.R. (3d) 24, 37 A.C.W.S. (3d) 847, 9 B.L.R. (2d) 275

Re Companies' Creditors Arrangement Act, R.S.C. 1985, c. C-36; Re Courts of Justice Act, R.S.O. 1990, c. C-43; Re plan of compromise in respect of LEHNDORFF GENERAL PARTNER LTD. (in its own capacity and in its capacity as general partner of LEHNDORFF UNITED PROPERTIES (CANADA), LEHNDORFF PROPERTIES (CANADA) and LEHNDORFF PROPERTIES (CANADA) II) and in respect of certain of their nominees LEHNDORFF UNITED PROPERTIES (CANADA) LTD., LEHNDORFF CANADIAN HOLDINGS LTD., LEHNDORFF CANADIAN HOLDINGS II LTD., BAYTEMP PROPERTIES LIMITED and 102 BLOOR STREET WEST LIMITED and in respect of THG LEHNDORFF VERMÖGENSVERWALTUNG GmbH (in its capacity as limited partner of LEHNDORFF UNITED PROPERTIES (CANADA))

Farley J.

Heard: December 24, 1992
Judgment: January 6, 1993
Docket: Doc. B366/92

Counsel: *Alfred Apps, Robert Harrison* and *Melissa J. Kennedy* , for applicants.
L. Crozier , for Royal Bank of Canada.
R.C. Heintzman , for Bank of Montreal.
J. Hodgson, Susan Lundy and *James Hilton* , for Canada Trustco Mortgage Corporation.
Jay Schwartz , for Citibank Canada.
Stephen Golick , for Peat Marwick Thorne* Inc., proposed monitor.
John Teolis , for Fuji Bank Canada.
Robert Thorton , for certain of the advisory boards.

Subject: Corporate and Commercial; Insolvency

Headnote

Corporations --- Arrangements and compromises — Under Companies' Creditors Arrangements Act — Arrangements — Effect of arrangement — Stay of proceedings

Corporations — Arrangements and compromises — Companies' Creditors Arrangement Act — Stay of proceedings — Stay being granted even where it would affect non-applicants that were not companies within meaning of Act — Business operations of applicants and non-applicants being so intertwined as to make stay appropriate.

The applicant companies were involved in property development and management and sought the protection of the *Companies' Creditors Arrangement Act* ("CCAA") in order that they could present a plan of compromise. They also sought a stay of all proceedings against the individual company applicants either in their own capacities or because of their interest in a larger group of companies. Each of the applicant companies was insolvent and had outstanding debentures issued under trust deeds. They proposed a plan of compromise among themselves and the holders of the debentures as well as those others of their secured and unsecured creditors deemed appropriate in the circumstances.

A question arose as to whether the court had the power to grant a stay of proceedings against non-applicants that were not companies and, therefore, not within the express provisions of the CCAA.

Held:

The application was allowed.

It was appropriate, given the significant financial intertwining of the applicant companies, that a consolidated plan be approved. Further, each of the applicant companies had a realistic possibility of being able to continue operating even though each was currently unable to meet all of its expenses. This was precisely the sort of situation in which all of the creditors would likely benefit from the application of the CCAA and in which it was appropriate to grant an order staying proceedings.

The inherent power of the court to grant stays can be used to supplement s. 11 of the CCAA when it is just and reasonable to do so. Clearly, the court had the jurisdiction to grant a stay in respect of any of the applicants that were companies fitting the criteria in the CCAA. However, the stay requested also involved limited partnerships where (1) the applicant companies acted on behalf of the limited partnerships, or (2) the stay would be effective against any proceedings taken by any party against the property assets and undertakings of the limited partnerships in which they held a direct interest. The business operations of the applicant companies were so intertwined with the limited partnerships that it would be impossible for a stay to be granted to the applicant companies that would affect their business without affecting the undivided interest of the limited partnerships in the business. As a result, it was just and reasonable to supplement s. 11 and grant the stay.

While the provisions of the CCAA allow for a cramdown of a creditor's claim, as well as the interest of any other person, anyone wishing to start or continue proceedings against the applicant companies could use the comeback clause in the order to persuade the court that it would not be just and reasonable to maintain the stay. In such a motion, the onus would be on the applicant companies to show that it was appropriate in the circumstances to continue the stay.

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Associated Investors of Canada Ltd., Re, 67 C.B.R. (N.S.) 237 , Alta. L.R. (2d) 259, [1988] 2 W.W.R. 211, 38 B.L.R. 148, *(*sub nom. *Re First Investors Corp.)* 46 D.L.R. (4th) 669 (Q.B.) , reversed (1988), 71 C.B.R. 71, 60 Alta. L.R. (2d) 242, 89 A.R. 344 (C.A.) — *referred to*

Campeau v. Olympia & York Developments Ltd. (1992), 14 C.B.R. (3d) 303 (Ont. Gen. Div.) — *referred to*

Canada Systems Group (EST) v. Allen-Dale Mutual Insurance Co. (1982), 29 C.P.C. 60, 137 D.L.R. (3d) 287 (Ont. H.C.) [affirmed (1983), 41 O.R. (2d) 135, 33 C.P.C. 210, 145 D.L.R. (3d) 266 (C.A.)] — *referred to*

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Feifer v. Frame Manufacturing Corp., Re, 28 C.B.R. 124, [1947] Que. K.B. 348 (C.A.) — *referred to*

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Gaz Métropolitain v. Wynden Canada Inc. (1982), 44 C.B.R. (N.S.) 285 (C.S. Que.) [affirmed (1982), 45 C.B.R. (N.S.) 11 (Que. C.A.)] — *referred to*

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Quintette Coal Ltd. v. Nippon Steel Corp. (1990), 2 C.B.R. (3d) 303, 51 B.C.L.R. (2d) 105 (C.A.) , affirming (1990), 2 C.B.R. (3d) 291, 47 B.C.L.R. (2d) 193 (S.C.) , leave to appeal to S.C.C. refused (1991), 7 C.B.R. (3d) 164 (note), 55 B.C.L.R. (2d) xxxiii (note), 135 N.R. 317 (note) — *referred to*

Reference re Companies' Creditors Arrangement Act (Canada), [1934] S.C.R. 659, 16 C.B.R. 1, [1934] 4 D.L.R. 75 — *referred to*

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Sklar-Peppler Furniture Corp. v. Bank of Nova Scotia (1991), 8 C.B.R. (3d) 312, 86 D.L.R. (4th) 621 (Ont. Gen. Div.) — *referred to*

Slavik, Re (1992), 12 C.B.R. (3d) 157 (B.C. S.C.) — *considered*

Stephanie's Fashions Ltd., Re (1990), 1 C.B.R. (3d) 248 (B.C. S.C.) — *referred to*

Ultracare Management Inc. v. Zevenberger (Trustee of) (1990), 3 C.B.R. (3d) 151, *(*sub nom. *Ultracare Management Inc. v. Gammon)* 1 O.R. (3d) 321 (Gen. Div.) — *referred to*

United Maritime Fishermen Co-operative, Re (1988), 67 C.B.R. (N.S.) 44, 84 N.B.R. (2d) 415, 214 A.P.R. 415 (Q.B.) , varied on reconsideration (1988), 68 C.B.R. (N.S.) 170, 87 N.B.R. (2d) 333, 221 A.P.R. 333 (Q.B.) , reversed (1988), 69 C.B.R. (N.S.) 161, 88 N.B.R. (2d) 253, 224 A.P.R. 253, *(*sub nom. *Cdn. Co-op. Leasing Services v. United Maritime Fishermen Co-op.)* 51 D.L.R. (4th) 618 (C.A.) — *referred to*

Statutes considered:

Bankruptcy Act, R.S.C. 1985, c. B-3 —

s. 85

s. 142

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

s. 2

s. 3

s. 4

s. 5

s. 6

s. 7

s. 8

s. 11

Courts of Justice Act, R.S.O. 1990, c. C.43.

Judicature Act, The, R.S.O. 1937, c. 100.

Limited Partnerships Act, R.S.O. 1990, c. L.16 —

s. 2(2)

s. 3(1)

s. 8

s. 9

s. 11

s. 12(1)

s. 13

s. 15(2)

s. 24

Partnership Act, R.S.A. 1980, c.P-2 — Pt. 2

s. 75

Rules considered:

Ontario, Rules of Civil Procedure —

r. 8.01

r. 8.02

Application under Companies' Creditors Arrangement Act to file consolidated plan of compromise and for stay of proceedings.

***Farley J.*:**

1 These are my written reasons relating to the relief granted the applicants on December 24, 1992 pursuant to their application under the *Companies' Creditors Arrangement Act* , R.S.C. 1985, c. C-36 ("CCAA") and the *Courts of Justice Act* , R.S.O. 1990, c. C.43 ("CJA"). The relief sought was as follows:

(a) short service of the notice of application;

(b) a declaration that the applicants were companies to which the CCAA applies;

(c) authorization for the applicants to file a consolidated plan of compromise;

(d) authorization for the applicants to call meetings of their secured and unsecured creditors to approve the consolidated plan of compromise;

(e) a stay of all proceedings taken or that might be taken either in respect of the applicants in their own capacity or on account of their interest in Lehndorff United Properties (Canada) ("LUPC"), Lehndorff Properties (Canada) ("LPC") and Lehndorff Properties (Canada) II ("LPC II") and collectively (the "Limited Partnerships") whether as limited partner, as general partner or as registered titleholder to certain of their assets as bare trustee and nominee; and

(f) certain other ancillary relief.

2 The applicants are a number of companies within the larger Lehndorff group ("Group") which operates in Canada and elsewhere. The group appears to have suffered in the same way that a number of other property developers and managers which have also sought protection under the CCAA in recent years. The applicants are insolvent; they each have outstanding debentures issues under trust deeds; and they propose a plan of compromise among themselves and the holders of these debentures as well as those others of their secured and unsecured creditors as they deemed appropriate in the circumstances. Each applicant except THG Lehndorff Vermögensverwaltung GmbH ("GmbH") is an Ontario corporation. GmbH is a company incorporated under the laws of Germany. Each of the applicants has assets or does business in Canada. Therefore each is a "company" within the definition of s. 2 of the CCAA. The applicant Lehndorff

General Partner Ltd. ("General Partner Company") is the sole general partner of the Limited Partnerships. The General Partner Company has sole control over the property and businesses of the Limited Partnerships. All major decisions concerning the applicants (and the Limited Partnerships) are made by management operating out of the Lehndorff Toronto Office. The applicants aside from the General Partner Company have as their sole purpose the holding of title to properties as bare trustee or nominee on behalf of the Limited Partnerships. LUPC is a limited partnership registered under the *Limited Partnership Act* , R.S.O. 1990, c. L.16 ("Ontario LPA"). LPC and LPC II are limited partnerships registered under Part 2 of the *Partnership Act* , R.S.A. 1980, c. P-2 ("Alberta PA") and each is registered in Ontario as an extra provincial limited partnership. LUPC has over 2,000 beneficial limited partners, LPC over 500 and LPC II over 250, most of whom are residents of Germany. As at March 31, 1992 LUPC had outstanding indebtedness of approximately $370 million, LPC $45 million and LPC II $7 million. Not all of the members of the Group are making an application under the CCAA. Taken together the Group's indebtedness as to Canadian matters (including that of the applicants) was approximately $543 million. In the summer of 1992 various creditors (Canada Trustco Mortgage Company, Bank of Montreal, Royal Bank of Canada, Canadian Imperial Bank of Commerce and the Bank of Tokyo Canada) made demands for repayment of their loans. On November 6, 1992 Funtanua Investments Limited, a minor secured lendor also made a demand. An interim standstill agreement was worked out following a meeting of July 7, 1992. In conjunction with Peat Marwick Thorne Inc. which has been acting as an informal monitor to date and Fasken Campbell Godfrey the applicants have held multiple meetings with their senior secured creditors over the past half year and worked on a restructuring plan. The business affairs of the applicants (and the Limited Partnerships) are significantly intertwined as there are multiple instances of intercorporate debt, cross-default provisions and guarantees and they operated a centralized cash management system.

3 This process has now evolved to a point where management has developed a consolidated restructuring plan which plan addresses the following issues:

(a) The compromise of existing conventional, term and operating indebtedness, both secured and unsecured.

(b) The restructuring of existing project financing commitments.

(c) New financing, by way of equity or subordinated debt.

(d) Elimination or reduction of certain overhead.

(e) Viability of existing businesses of entities in the Lehndorff Group.

(f) Restructuring of income flows from the limited partnerships.

(g) Disposition of further real property assets aside from those disposed of earlier in the process.

(h) Consolidation of entities in the Group; and

(i) Rationalization of the existing debt and security structure in the continuing entities in the Group.

Formal meetings of the beneficial limited partners of the Limited Partnerships are scheduled for January 20 and 21, 1993 in Germany and an information circular has been prepared and at the time of hearing was being translated into German. This application was brought on for hearing at this time for two general reasons: (a) it had now ripened to the stage of proceeding with what had been distilled out of the strategic and consultative meetings; and (b) there were creditors other than senior secured lenders who were in a position to enforce their rights against assets of some of the applicants (and Limited Partnerships) which if such enforcement did take place would result in an undermining of the overall plan. Notice of this hearing was given to various creditors: Barclays Bank of Canada, Barclays Bank PLC, Bank of Montreal, Citibank Canada, Canada Trustco Mortgage Corporation, Royal Trust Corporation of Canada, Royal Bank of Canada, the Bank of Tokyo Canada, Funtauna Investments Limited, Canadian Imperial Bank of Commerce, Fuji Bank Canada and First City Trust Company. In this respect the applicants have recognized that although the initial application under the CCAA may be made on an ex parte basis (s. 11 of the CCAA; *Re Langley's Ltd.*, [1938] O.R. 123, [1938] 3 D.L.R. 230 (C.A.) ; *Re Keppoch Development Ltd.* (1991), 8 C.B.R. (3d) 95 (N.S. T.D.) . The court will be concerned when major creditors have not been alerted even in the most minimal fashion (*Re Inducon Development Corp.* (1992), 8 C.B.R. (3d) 306 (Ont. Gen. Div.) at p. 310). The application was either supported or not opposed.

4 "Instant" debentures are now well recognized and respected by the courts: see *Re United Maritime Fishermen Co-operative* (1988), 67 C.B.R. (N.S.) 44 (N.B. Q.B.) , at pp. 55-56, varied on reconsideration (1988), 68 C.B.R. (N.S.) 170 (N.B. Q.B.) , reversed on different grounds (1988), 69 C.B.R. (N.S.) 161 (N.B. C.A.) , at pp. 165-166; *Re Stephanie's Fashions Ltd.* (1990), 1 C.B.R. (3d) 248 (B.C. S.C.) at pp. 250-251; *Nova Metal Products Inc. v. Comiskey (Trustee of)* (sub nom. *Elan Corp. v. Comiskey*) (1990), 1 O.R. (3d) 289, 1 C.B.R. (3d) 101 (C.A.) per Doherty J.A., dissenting on another point, at pp. 306-310 (O.R.); *Ultracare Management Inc. v. Zevenberger (Trustee of)* (sub nom. *Ultracare Management Inc. v. Gammon*) (1990), 1 O.R. (3d) 321 (Gen. Div.) at p. 327. The applicants would appear to me to have met the technical hurdle of s. 3 and as defined s. 2) of the CCAA in that they are debtor companies since they are insolvent, they have outstanding an issue of debentures under a trust deed and the compromise or arrangement that is proposed includes that compromise between the applicants and the holders of those trust deed debentures. I am also satisfied that because of the significant intertwining of the applicants it would be appropriate to have a consolidated plan. I would also understand that this court (Ontario Court of Justice (General Division)) is the appropriate court to hear this application since all the applicants except GmbH have their head office or their chief place of business in Ontario and GmbH, although it does not have a place of business within Canada, does have assets located within Ontario.

5 The CCAA is intended to facilitate compromises and arrangements between companies and their creditors as an alternative to bankruptcy and, as such, is remedial legislation entitled to a liberal interpretation. It seems to me that the purpose of the statute is to enable insolvent companies to carry on business in the ordinary course or otherwise deal with their assets so as to enable plan of compromise or arrangement to be prepared, filed and considered by their creditors and the court. In the interim, a judge has great discretion under the CCAA to make order so as to effectively maintain the status quo in respect of an insolvent company while it attempts to gain the approval of its creditors for the proposed compromise or arrangement which will be to the benefit of both the company and its creditors. See the preamble to and sections 4, 5, 6, 7, 8 and 11 of the CCAA; *Reference re Companies' Creditors Arrangement Act*, [1934] S.C.R. 659 at p. 661, 16 C.B.R. 1, [1934] 4 D.L.R. 75 ; *Meridian Developments Inc. v. Toronto Dominion Bank*, [1984] 5 W.W.R. 215 (Alta. Q.B.) at pp. 219-220; *Norcen Energy Resources Ltd. v. Oakwood Petroleums Ltd.* (1988), 72 C.B.R. (N.S.) 1, 63 Alta. L.R. (2d) 361 (Q.B.) , at pp. 12-13 (C.B.R.); *Quintette Coal Ltd. v. Nippon Steel Corp.* (1990), 2 C.B.R. (3d) 303 (B.C. C.A.) , at pp. 310-311, affirming (1990), 2 C.B.R. (3d) 291, 47 B.C.L.R. (2d) 193 (S.C.) , leave to appeal to S.C.C. dismissed (1991), 7 C.B.R. (3d) 164 (S.C.C.) .; *Nova Metal Products Inc. v. Comiskey (Trustee of)* , supra, at p. 307 (O.R.); *Fine's Flowers v. Fine's Flowers (Creditors of)* (1992), 7 O.R. (3d) 193 (Gen. Div.) , at p. 199 and "Reorganizations Under The Companies' Creditors Arrangement Act", Stanley E. Edwards (1947) 25 Can. Bar Rev. 587 at p. 592.

6 The CCAA is intended to provide a structured environment for the negotiation of compromises between a debtor company and its creditors for the benefit of both. Where a debtor company realistically plans to continue operating or to otherwise deal with its assets but it requires the protection of the court in order to do so and it is otherwise too early for the court to determine whether the debtor company will succeed, relief should be granted under the CCAA. see *Nova Metal Products Inc. v. Comiskey (Trustee of)* , supra at pp. 297 and 316; *Re Stephanie's Fashions Ltd.* , supra, at pp. 251-252 and *Ultracare Management Inc. v. Zevenberger (Trustee of)* , supra, at p. 328 and p. 330. It has been held that the intention of the CCAA is to prevent any manoeuvres for positioning among the creditors during the period required to develop a plan and obtain approval of creditors. Such manoeuvres could give an aggressive creditor an advantage to the prejudice of others who are less aggressive and would undermine the company's financial position making it even less likely that the plan will succeed: see *Meridian Developments Inc. v. Toronto Dominion Bank* , supra, at p. 220 (W.W.R.). The possibility that one or more creditors may be prejudiced should not affect the court's exercise of its authority to grant a stay of proceedings under the CCAA because this affect is offset by the benefit to all creditors and to the company of facilitating a reorganization. The court's primary concerns under the CCAA must be for the debtor and *all* of the creditors: see *Quintette Coal Ltd. v. Nippon Steel Corp.* , supra, at pp. 108-110; *Hongkong Bank of Canada v. Chef Ready*

Foods Ltd. (1990), 4 C.B.R. (3d) 311, 51 B.C.L.R. (2d) 84 (C.A.) , at pp. 315-318 (C.B.R.) and *Re Stephanie's Fashions Ltd.* , supra, at pp. 251-252.

7 One of the purposes of the CCAA is to facilitate ongoing operations of a business where its assets have a greater value as part of an integrated system than individually. The CCAA facilitates reorganization of a company where the alternative, sale of the property piecemeal, is likely to yield far less satisfaction to the creditors. Unlike the *Bankruptcy Act* , R.S.C. 1985, c. B-3, before the amendments effective November 30, 1992 to transform it into the *Bankruptcy and Insolvency Act* ("BIA"), it is possible under the CCAA to bind secured creditors it has been generally speculated that the CCAA will be resorted to by companies that are generally larger and have a more complicated capital structure and that those companies which make an application under the BIA will be generally smaller and have a less complicated structure. Reorganization may include partial liquidation where it is intended as part of the process of a return to long term viability and profitability. See *Hongkong Bank of Canada v. Chef Ready Foods Ltd.* , supra, at p. 318 and *Re Associated Investors of Canada Ltd.* (1987), 67 C.B.R. (N.S.) 237 (Alta. Q.B.) at pp. 245, reversed on other grounds at (1988), 71 C.B.R. (N.S.) 71 (Alta. C.A.) . It appears to me that the purpose of the CCAA is also to protect the interests of creditors and to enable an orderly distribution of the debtor company's affairs. This may involve a winding-up or liquidation of a company or simply a substantial downsizing of its business operations, provided the same is proposed in the best interests of the creditors generally. See *Re Associated Investors of Canada Ltd.* , supra, at p. 318; *Re Amirault Fish Co.*, 32 C.B.R. 186, [1951] 4 D.L.R. 203 (N.S. T.D.) at pp. 187-188 (C.B.R.).

8 It strikes me that each of the applicants in this case has a realistic possibility of being able to continue operating, although each is currently unable to meet all of its expenses albeit on a reduced scale. This is precisely the sort of circumstance in which all of the creditors are likely to benefit from the application of the CCAA and in which it is appropriate to grant an order staying proceedings so as to allow the applicant to finalize preparation of and file a plan of compromise and arrangement.

9 Let me now review the aspect of the stay of proceedings. Section 11 of the CCAA provides as follows:

> 11. Notwithstanding anything in the *Bankruptcy Act* or the *Winding-up Act* , whenever an application has been made under this Act in respect of any company, the court, on the application of any person interested in the matter, may, on notice to any other person or without notice as it may see fit,
>
> (*a*) make an order staying, until such time as the court may prescribe or until any further order, all proceedings taken or that might be taken in respect of the company under the *Bankruptcy Act* and the *Winding-up Act* or either of them;
>
> (*b*) restrain further proceedings in any action, suit or proceeding against the company on such terms as the court sees fit; and
>
> (*c*) make an order that no suit, action or other proceeding shall be proceeded with or commenced against the company except with the leave of the court and subject to such terms as the court imposes.

10 The power to grant a stay of proceeding should be construed broadly in order to permit the CCAA to accomplish its legislative purpose and in particular to enable continuance of the company seeking CCAA protection. The power to grant a stay therefore extends to a stay which affected the position not only of the company's secured and unsecured creditors, but also all non-creditors and other parties who could potentially jeopardize the success of the plan and thereby the continuance of the company. See *Norcen Energy Resources Ltd. v. Oakwood Petroleums Ltd.* , supra, at pp. 12-17 (C.B.R.) and *Quintette Coal Ltd. v. Nippon Steel Corp.* , supra, at pp. 296-298 (B.C. S.C.) and pp. 312-314 (B.C. C.A.) and *Meridian Developments Inc. v. Toronto Dominion Bank* , supra, at pp. 219 ff. Further the court has the power to order a stay that is effective in respect of the rights arising in favour of secured creditors under all forms of commercial security: see *Hongkong Bank of Canada v. Chef Ready Foods Ltd.* , supra, at p. 320 where Gibbs J.A. for the court stated:

> The trend which emerges from this sampling will be given effect here by holding that where the word "security" occurs in the C.C.A.A., it includes s. 178 security and, where the word creditor occurs, it includes a bank holding

> s. 178 security. To the extent that there may be conflict between the two statutes, therefore, the broad scope of the C.C.A.A. prevails.

11 The power to grant a stay may also extend to preventing persons seeking to terminate or cancel executory contracts, including, without limitation agreements with the applying companies for the supply of goods or services, from doing so: see *Gaz Métropolitain v. Wynden Canada Inc.* (1982), 44 C.B.R. (N.S.) 285 (C.S. Que.) at pp. 290-291 and *Quintette Coal Ltd. v. Nippon Steel Corp.* , supra, at pp. 311-312 (B.C. C.A.). The stay may also extend to prevent a mortgagee from proceeding with foreclosure proceedings (see *Re Northland Properties Ltd.* (1988), 73 C.B.R. (N.S.) 141 (B.C. S.C.) or to prevent landlords from terminating leases, or otherwise enforcing their rights thereunder (see *Feifer v. Frame Manufacturing Corp.* (1947), 28 C.B.R. 124 (C.A. Que.)). Amounts owing to landlords in respect of arrears of rent or unpaid rent for the unexpired portion of lease terms are properly dealt with in a plan of compromise or arrangement: see *Sklar-Peppler Furniture Corp. v. Bank of Nova Scotia* (1991), 8 C.B.R. (3d) 312 (Ont. Gen. Div.) especially at p. 318. The jurisdiction of the court to make orders under the CCAA in the interest of protecting the debtor company so as to enable it to prepare and file a plan is effective notwithstanding the terms of any contract or instrument to which the debtor company is a party. Section 8 of the CCAA provides:

> 8. This Act extends and does not limit the provisions of any instrument now or hereafter existing that governs the rights of creditors or any class of them and has full force and effect notwithstanding anything to the contrary contained in that instrument.

The power to grant a stay may also extend to prevent persons from exercising any right of set off in respect of the amounts owed by such a person to the debtor company, irrespective of whether the debtor company has commenced any action in respect of which the defense of set off might be formally asserted: see *Quintette Coal Ltd. v. Nippon Steel Corp.* , supra, at pp. 312-314 (B.C.C.A.).

12 It was submitted by the applicants that the power to grant a stay of proceedings may also extend to a stay of proceedings against non-applicants who are not companies and accordingly do not come within the express provisions of the CCAA. In support thereof they cited a CCAA order which was granted staying proceedings against individuals who guaranteed the obligations of a debtor-applicant which was a qualifying company under the terms of the CCAA: see *Re Slavik* , unreported, [1992] B.C.J. No. 341 [now reported at 12 C.B.R. (3d) 157 (B.C. S.C.)]. However in the *Slavik* situation the individual guarantors were officers and shareholders of two companies which had sought and obtained CCAA protection. Vickers J. in that case indicated that the facts of that case included the following unexplained and unamplified fact [at p. 159]:

> 5. The order provided further that all creditors of Norvik Timber Inc. be enjoined from making demand for payment upon that firm or upon any guarantor of an obligation of the firm until further order of the court.

The CCAA reorganization plan involved an assignment of the claims of the creditors to "Newco" in exchange for cash and shares. However the basis of the stay order originally granted was not set forth in this decision.

13 It appears to me that Dickson J. in *International Donut Corp. v. 050863 N.D. Ltd.* , unreported, [1992] N.B.J. No. 339 (N.B. Q.B.) [now reported at 127 N.B.R. (2d) 290, 319 A.P.R. 290] was focusing only on the stay arrangements of the CCAA when concerning a limited partnership situation he indicated [at p. 295 N.B.R.]:

> In August 1991 the limited partnership, through its general partner the plaintiff, applied to the Court under the *Companies' Creditors Arrangement Act* , R.S.C., c. C-36 for an order delaying the assertion of claims by creditors until an opportunity could be gained to work out with the numerous and sizable creditors a compromise of their claims. An order was obtained but it in due course expired without success having been achieved in arranging with creditors a compromise. *That effort may have been wasted, because it seems questionable that the federal Act could have any application to a limited partnership in circumstances such as these* . (Emphasis added.)

14 I am not persuaded that the words of s. 11 which are quite specific as relating as to a *company* can be enlarged to encompass something other than that. However it appears to me that Blair J. was clearly in the right channel in his analysis in *Campeau v. Olympia & York Developments Ltd.* unreported, [1992] O.J. No. 1946 [now reported at 14 C.B.R. (3d) 303 (Ont. Gen. Div.)] at pp. 4-7 [at pp. 308-310 C.B.R.].

The Power to Stay

The court has always had an inherent jurisdiction to grant a stay of proceedings whenever it is just and convenient to do so, in order to control its process or prevent an abuse of that process: see *Canada Systems Group (EST) Ltd. v. Allendale Mutual Insurance Co.* (1982), 29 C.P.C. 60, 137 D.L.R. (3d) 287 (Ont. H.C.) , and cases referred to therein. In the civil context, this general power is also embodied in the very broad terms of s. 106 of the *Courts of Justice Act* , R.S.O. 1990, c. C.43, which provides as follows:

> 106. A court, on its own initiative or on motion by any person, whether or not a party, may stay any proceeding in the court on such terms as are considered just.

Recently, Mr. Justice O'Connell has observed that this discre tionary power is "highly dependent on the facts of each particular case": *Arab Monetary Fund v. Hashim* (unreported) [(June 25, 1992), Doc. 24127/88 (Ont. Gen. Div.)], [1992] O.J. No. 1330.

Apart from this inherent and general jurisdiction to stay proceedings, there are many instances where the court is specifically granted the power to stay in a particular context, by virtue of statute or under the *Rules of Civil Procedure* . The authority to prevent multiplicity of proceedings in the same court, under r. 6.01(1), is an example of the latter. The power to stay judicial and extra-judicial proceedings under s. 11 of the C.C.A.A., is an example of the former. Section 11 of the C.C.A.A. provides as follows.

The Power to Stay in the Context of C.C.A.A. Proceedings

By its formal title the C.C.A.A. is known as "An Act to facilitate compromises and arrangements between companies and their creditors". To ensure the effective nature of such a "facilitative" process it is essential that the debtor company be afforded a respite from the litigious and other rights being exercised by creditors, while it attempts to carry on as a going concern and to negotiate an acceptable corporate restructuring arrangement with such creditors.

In this respect it has been observed that the C.C.A.A. is "to be used as a practical and effective way of restructuring corporate indebtedness.": see the case comment following the report of *Norcen Energy Resources Ltd. v. Oakwood Petroleums Ltd.* (1988), 72 C.B.R. (N.S.) 1, 63 Alta. L.R. (2d) 361, 92 A.R. 81 (Q.B.) , and the approval of that remark as "a perceptive observation about the attitude of the courts" by Gibbs J.A. in *Quintette Coal Ltd. v. Nippon Steel Corp.* (1990), 51 B.C.L.R. (2d) 105 (C.A.) at p. 113 [B.C.L.R.].

Gibbs J.A. continued with this comment:

> To the extent that a general principle can be extracted from the few cases directly on point, and the others in which there is persuasive obiter, it would appear to be that the courts have concluded that under s. 11 there is *a discretionary power to restrain judicial or extra-judicial conduct* against the debtor company *the effect of which is, or would be, seriously to impair the ability of the debtor company to continue in business during the compromise or arrangement negotiating period* .

(emphasis added)

I agree with those sentiments and would simply add that, in my view, the restraining power extends as well to conduct which could seriously impair the debtor's ability to focus and concentrate its efforts on the business purpose of

> negotiating the compromise or arrangement. [In this respect, see also *Sairex GmbH v. Prudential Steel Ltd.* (1991), 8 C.B.R. (3d) 62 (Ont. Gen. Div.) at p. 77.]
>
> I must have regard to these foregoing factors while I consider, as well, the general principles which have historically governed the court's exercise of its power to stay proceedings. These principles were reviewed by Mr. Justice Montgomery in *Canada Systems Group (EST) Ltd. v. Allendale Mutual Insurance* , supra (a "Mississauga Derailment" case), at pp. 65-66 [C.P.C.]. The balance of convenience must weigh significantly in favour of granting the stay, as a party's right to have access to the courts must not be lightly interfered with. The court must be satisfied that a continuance of the proceeding would serve as an injustice to the party seeking the stay, in the sense that it would be oppressive or vexatious or an abuse of the process of the court in some other way. The stay must not cause an injustice to the plaintiff.

It is quite clear from *Empire-Universal Films Limited v. Rank*, [1947] O.R. 775 (H.C.) that McRuer C.J.H.C. considered that *The Judicature Act* [R.S.O. 1937, c. 100] then [and now the CJA] merely confirmed a statutory right that previously had been considered inherent in the jurisdiction of the court with respect to its authority to grant a stay of proceedings. See also *McCordic v. Bosanquet* (1974), 5 O.R. (2d) 53 (H.C.) and *Canada Systems Group (EST) Ltd. v. Allen-Dale Mutual Insurance Co.* (1982), 29 C.P.C. 60 (H.C.) at pp. 65-66.

15 Montgomery J. in *Canada Systems* , supra, at pp. 65-66 indicated:

> Goodman J. (as he then was) in *McCordic v. Bosanquet* (1974), 5 O.R. (2d) 53 in granting a stay reviewed the authorities and concluded that the inherent jurisdiction of the Court to grant a stay of proceedings may be made whenever it is just and reasonable to do so. "This court has ample jurisdiction to grant a stay whenever it is just and reasonable to do so." (Per Lord Denning M.R. in *Edmeades v. Thames Board Mills Ltd.*, [1969] 2 Q.B. 67 at 71, [1969] 2 All E.R. 127 (C.A.)). Lord Denning's decision in *Edmeades* was approved by Lord Justice Davies in *Lane v. Willis; Lane v. Beach (Executor of Estate of George William Willis)*, [1972] 1 All E.R. 430, *(*sub nom. *Lane v. Willis; Lane v. Beach)* [1972] 1 W.L.R. 326 (C.A.) .
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> . . . . .
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> In *Weight Watchers Int. Inc. v. Weight Watchers of Ont. Ltd.* (1972), 25 D.L.R. (3d) 419, 5 C.P.R. (2d) 122 , appeal allowed by consent without costs *(*sub nom. *Weight Watchers of Ont. Ltd. v. Weight Watchers Inc. Inc.)* 42 D.L.R. (3d) 320n, 10 C.P.R. (2d) 96n (Fed. C.A.) , Mr. Justice Heald on an application for stay said at p. 426 [25 D.L.R.]:
>
>> The principles which must govern in these matters are clearly stated in the case of *Empire Universal Films Ltd. et al. v. Rank et al.*, [1947] O.R. 775 at p. 779, as follows [quoting *St. Pierre et al. v. South American Stores (Gath & Chaves), Ltd. et al.*, [1936] 1 K.B. 382 at p. 398]:
>>
>>> (1.) A mere balance of convenience is not a sufficient ground for depriving a plaintiff of the advantages of prosecuting his action in an English Court if it is otherwise properly brought. The right of access to the King's Court must not be lightly refused. (2.) In order to justify a stay two conditions must be satisfied, one positive and the other negative: (a) the defendant must satisfy the Court that the continuance of the action would work an injustice because it would be oppressive or vexatious to him or would be an abuse of the process of the Court in some other way; and (b) the stay must not cause an injustice to the plaintiff. On both the burden of proof is on the defendant.

16 Thus it appears to me that the inherent power of this court to grant stays can be used to supplement s. 11 of the CCAA when it is just and reasonable to do so. Is it appropriate to do so in the circumstances? Clearly there is jurisdiction under s. 11 of the CCAA to grant a stay in respect of any of the applicants which are all companies which fit the criteria of the CCAA. However the stay requested also involved the limited partnerships to some degree either (i) with respect to the applicants acting on behalf of the Limited Partnerships or (ii) the stays being effective vis-à-vis any proceedings taken by any party against the property assets and undertaking of the Limited Partnerships in respect of which they

hold a direct interest (collectively the "Property") as set out in the terms of the stay provisions of the order paragraphs 4 through 18 inclusive attached as an appendix to these reasons. [Appendix omitted.] I believe that an analysis of the operations of a limited partnership in this context would be beneficial to an understanding of how there is a close inter-relationship to the applicants involved in this CCAA proceedings and how the Limited Partnerships and their Property are an integral part of the operations previously conducted and the proposed restructuring.

17 A limited partnership is a creation of statute, consisting of one or more general partners and one or more limited partners. The limited partnership is an investment vehicle for passive investment by limited partners. It in essence combines the flow through concept of tax depreciation or credits available to "ordinary" partners under general partnership law with limited liability available to shareholders under corporate law. See Ontario LPA sections 2(2) and 3(1) and Lyle R. Hepburn, *Limited Partnerships* , (Toronto: De Boo, 1991), at p. 1-2 and p. 1-12. I would note here that the limited partnership provisions of the Alberta PA are roughly equivalent to those found in the Ontario LPA with the interesting side aspect that the Alberta legislation in s. 75 does allow for judgment against a limited partner to be charged against the limited partner's interest in the limited partnership. A general partner has all the rights and powers and is subject to all the restrictions and liabilities of a partner in a partnership. In particular a general partner is fully liable to each creditor of the business of the limited partnership. The general partner has sole control over the property and business of the limited partnership: see Ontario LPA ss. 8 and 13. Limited partners have no liability to the creditors of the limited partnership's business; the limited partners' financial exposure is limited to their contribution. The limited partners do not have any "independent" ownership rights in the property of the limited partnership. The entitlement of the limited partners is limited to their contribution plus any profits thereon, after satisfaction of claims of the creditors. See Ontario LPA sections 9, 11, 12(1), 13, 15(2) and 24. The process of debtor and creditor relationships associated with the limited partnership's business are between the general partner and the creditors of the business. In the event of the creditors collecting on debt and enforcing security, the creditors can only look to the assets of the limited partnership together with the assets of the general partner including the general partner's interest in the limited partnership. This relationship is recognized under the *Bankruptcy Act* (now the BIA) sections 85 and 142.

18 A general partner is responsible to defend proceedings against the limited partnership in the firm name, so in procedural law and in practical effect, a proceeding against a limited partnership is a proceeding against the general partner. See Ontario *Rules of Civil Procedure* , O. Reg. 560/84, Rules 8.01 and 8.02.

19 It appears that the preponderance of case law supports the contention that contention that a partnership including a limited partnership is not a separate legal entity. See *Lindley on Partnership* , 15th ed. (London: Sweet & Maxwell, 1984), at pp. 33-35; *Seven Mile Dam Contractors v. R.* (1979), 13 B.C.L.R. 137 (S.C.) , affirmed (1980), 25 B.C.L.R. 183 (C.A.) and "Extra-Provincial Liability of the Limited Partner", Brad A. Milne, (1985) 23 Alta. L. Rev. 345, at pp. 350-351. Milne in that article made the following observations:

> The preponderance of case law therefore supports the contention that a limited partnership is not a separate legal entity. It appears, nevertheless, that the distinction made in *Re Thorne* between partnerships and trade unions could not be applied to limited partnerships which, like trade unions, must rely on statute for their validity. The mere fact that limited partnerships owe their existence to the statutory provision is probably not sufficient to endow the limited partnership with the attribute of legal personality as suggested in *Ruzicks* unless it appeared that the Legislature clearly intended that the limited partnership should have a separate legal existence. A review of the various provincial statutes does not reveal any procedural advantages, rights or powers that are fundamentally different from those advantages enjoyed by ordinary partnerships. The legislation does not contain any provision resembling section 15 of the *Canada Business Corporation Act* [S.C. 1974-75, c. 33, as am.] which expressly states that a corporation has the capacity, both in and outside of Canada, of a natural person. It is therefore difficult to imagine that the Legislature intended to create a new category of legal entity.

20 It appears to me that the operations of a limited partnership in the ordinary course are that the limited partners take a completely passive role (they must or they will otherwise lose their limited liability protection which would have been their sole reason for choosing a limited partnership vehicle as opposed to an "ordinary" partnership vehicle). For

a lively discussion of the question of "control" in a limited partnership as contrasted with shareholders in a corporation, see R. Flannigan, "The Control Test of Investor Liability in Limited Partnerships" (1983) 21 Alta. L. Rev. 303; E. Apps, "Limited Partnerships and the 'Control' Prohibition: Assessing the Liability of Limited Partners" (1991) 70 Can. Bar Rev. 611; R. Flannigan, "Limited Partner Liability: A Response" (1992) 71 Can. Bar Rev. 552. The limited partners leave the running of the business to the general partner and in that respect the care, custody and the maintenance of the property, assets and undertaking of the limited partnership in which the limited partners and the general partner hold an interest. The ownership of this limited partnership property, assets and undertaking is an undivided interest which cannot be segregated for the purpose of legal process. It seems to me that there must be afforded a protection of the whole since the applicants' individual interest therein cannot be segregated without in effect dissolving the partnership arrangement. The limited partners have two courses of action to take if they are dissatisfied with the general partner or the operation of the limited partnership as carried on by the general partner — the limited partners can vote to (a) remove the general partner and replace it with another or (b) dissolve the limited partnership. However Flannigan strongly argues that an unfettered right to remove the general partner would attach general liability for the limited partners (and especially as to the question of continued enjoyment of favourable tax deductions) so that it is prudent to provide this as a conditional right: *Control Test* , (1992), supra, at pp. 524-525. Since the applicants are being afforded the protection of a stay of proceedings in respect to allowing them time to advance a reorganization plan and complete it if the plan finds favour, there should be a stay of proceedings (vis-à-vis any action which the limited partners may wish to take as to replacement or dissolution) through the period of allowing the limited partners to vote on the reorganization plan itself.

21 It seems to me that using the inherent jurisdiction of this court to supplement the statutory stay provisions of s. 11 of the CCAA would be appropriate in the circumstances; it would be just and reasonable to do so. The business operations of the applicants are so intertwined with the limited partnerships that it would be impossible for relief as to a stay to be granted to the applicants which would affect their business without at the same time extending that stay to the undivided interests of the limited partners in such. It also appears that the applicants are well on their way to presenting a reorganization plan for consideration and a vote; this is scheduled to happen within the month so there would not appear to be any significant time inconvenience to any person interested in pursuing proceedings. While it is true that the provisions of the CCAA allow for a cramdown of a creditor's claim (as well as an interest of any other person), those who wish to be able to initiate or continue proceedings against the applicants may utilize the comeback clause in the order to persuade the court that it would not be just and reasonable to maintain that particular stay. It seems to me that in such a comeback motion the onus would be upon the applicants to show that in the circumstances it was appropriate to continue the stay.

22 The order is therefore granted as to the relief requested including the proposed stay provisions.

Application allowed.

Footnotes

* As amended by the court.

End of Document

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2000 ABQB 442
Alberta Court of Queen's Bench

Canadian Airlines Corp., Re

2000 CarswellAlta 662, 2000 ABQB 442, [2000] 10 W.W.R. 269, [2000] A.W.L.D. 654, [2000] A.J. No. 771, 20 C.B.R. (4th) 1, 265 A.R. 201, 84 Alta. L.R. (3d) 9, 98 A.C.W.S. (3d) 334, 9 B.L.R. (3d) 41

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

In the Matter of the Business Corporations Act (Alberta) S.A. 1981, c. B-15, as Amended, Section 185

In the Matter of Canadian Airlines Corporation and Canadian Airlines International Ltd.

Paperny J.

Heard: June 5-19, 2000
Judgment: June 27, 2000 *
Docket: Calgary 0001-05071

Counsel: *A.L. Friend, Q.C.*, *H.M. Kay, Q.C.*, *R.B. Low, Q.C.*, and *L. Goldbach*, for Petitioners.
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L.R. Duncan, Q.C., and *G. McCue*, for Neil Baker, Michael Salter, Hal Metheral, and Roger Midiaty.
F.R. Foran, Q.C., and *P.T. McCarthy, Q.C.*, for Monitor, PwC.
G.B. Morawetz, *R.J. Chadwick* and *A. McConnell*, for Senior Secured Noteholders and the Bank of Nova Scotia Trust Co.
C.J. Shaw, Q.C., for Unionized Employees.
T. Mallett and *C. Feasby*, for Amex Bank of Canada.
E.W. Halt, for J. Stephens Allan, Claims Officer.
M. Hollins, for Pacific Costal Airlines.
P. Pastewka, for JHHD Aircraft Leasing No. 1 and No. 2.
J. Thom, for Royal Bank of Canada.
J. Medhurst-Tivadar, for Canada Customs and Revenue Agency.
R. Wilkins, Q.C., for Calgary and Edmonton Airport Authority.

Subject: Corporate and Commercial; Insolvency

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s. 167(1) [am. 1996, c. 32, s. 1(4)] — considered

s. 167(1)(e) — considered

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s. 185(2) — considered

s. 185(7) — considered

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s. 5.1(2) [en. 1997, c. 12, s. 122] — referred to

s. 6 [am. 1992, c. 27, s. 90(1)(f); am. 1996, c. 6, s. 167(1)(d)] — considered

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APPLICATION by airline for approval of plan of arrangement; COUNTER-APPLICATION by investment corporation for declaration that plan constituted merger or transfer of airline's assets to AC Corp., that plan would not affect investment corporation, and directing repurchase of notes pursuant to trust indenture, and that actions of airline and AC Corp. in formulating plan were oppressive and unfairly prejudicial; COUNTER-APPLICATION by minority shareholders.

***Paperny J.*:**

I. Introduction

1 After a decade of searching for a permanent solution to its ongoing, significant financial problems, Canadian Airlines Corporation ("CAC") and Canadian Airlines International Ltd. ("CAIL") seek the court's sanction to a plan of arrangement filed under the *Companies' Creditors Arrangement Act* ("CCAA") and sponsored by its historic rival, Air Canada Corporation ("Air Canada"). To Canadian, this represents its last choice and its only chance for survival. To Air Canada, it is an opportunity to lead the restructuring of the Canadian airline industry, an exercise many suggest is long overdue. To over 16,000 employees of Canadian, it means continued employment. Canadian Airlines will operate as a separate entity and continue to provide domestic and international air service to Canadians. Tickets of the flying public will be honoured and their frequent flyer points maintained. Long term business relationships with trade creditors and suppliers will continue.

2 The proposed restructuring comes at a cost. Secured and unsecured creditors are being asked to accept significant compromises and shareholders of CAC are being asked to accept that their shares have no value. Certain unsecured creditors oppose the plan, alleging it is oppressive and unfair. They assert that Air Canada has appropriated the key assets of Canadian to itself. Minority shareholders of CAC, on the other hand, argue that Air Canada's financial support to Canadian, before and during this restructuring process, has increased the value of Canadian and in turn their shares. These two positions are irreconcilable, but do reflect the perception by some that this plan asks them to sacrifice too much.

3 Canadian has asked this court to sanction its plan under s. 6 of the CCAA. The court's role on a sanction hearing is to consider whether the plan fairly balances the interests of all the stakeholders. Faced with an insolvent organization, its role is to look forward and ask: does this plan represent a fair and reasonable compromise that will permit a viable commercial entity to emerge? It is also an exercise in assessing current reality by comparing available commercial alternatives to what is offered in the proposed plan.

II. Background

Canadian Airlines and its Subsidiaries

4 CAC and CAIL are corporations incorporated or continued under the *Business Corporations Act* of Alberta, S.A. 1981, c. B-15 ("ABCA"). 82% of CAC's shares are held by 853350 Alberta Ltd.("853350") and the remaining 18% are held publicly. CAC, directly or indirectly, owns the majority of voting shares in and controls the other Petitioner, CAIL and these shares represent CAC's principal asset. CAIL owns or has an interest in a number of other corporations directly engaged in the airline industry or other businesses related to the airline industry, including Canadian Regional Airlines Limited ("CRAL"). Where the context requires, I will refer to CAC and CAIL jointly as "Canadian" in these reasons.

5 In the past fifteen years, CAIL has grown from a regional carrier operating under the name Pacific Western Airlines ("PWA") to one of Canada's two major airlines. By mid-1986, Canadian Pacific Air Lines Limited ("CP Air"), had acquired the regional carriers Nordair Inc. ("Nordair") and Eastern Provincial Airways ("Eastern"). In February, 1987, PWA completed its purchase of CP Air from Canadian Pacific Limited. PWA then merged the four predecessor carriers (CP Air, Eastern, Nordair, and PWA) to form one airline, "Canadian Airlines International Ltd.", which was launched in April, 1987.

6 By April, 1989, CAIL had acquired substantially all of the common shares of Wardair Inc. and completed the integration of CAIL and Wardair Inc. in 1990.

7 CAIL and its subsidiaries provide international and domestic scheduled and charter air transportation for passengers and cargo. CAIL provides scheduled services to approximately 30 destinations in 11 countries. Its subsidiary, Canadian Regional Airlines (1998) Ltd. ("CRAL 98") provides scheduled services to approximately 35 destinations in Canada and the United States. Through code share agreements and marketing alliances with leading carriers, CAIL and its subsidiaries provide service to approximately 225 destinations worldwide. CAIL is also engaged in charter and cargo services and the provision of services to third parties, including aircraft overhaul and maintenance, passenger and cargo handling, flight simulator and equipment rentals, employee training programs and the sale of Canadian Plus frequent flyer points. As at December 31, 1999, CAIL operated approximately 79 aircraft.

8 CAIL directly and indirectly employs over 16,000 persons, substantially all of whom are located in Canada. The balance of the employees are located in the United States, Europe, Asia, Australia, South America and Mexico. Approximately 88% of the active employees of CAIL are subject to collective bargaining agreements.

Events Leading up to the CCAA Proceedings

9 Canadian's financial difficulties significantly predate these proceedings.

10 In the early 1990s, Canadian experienced significant losses from operations and deteriorating liquidity. It completed a financial restructuring in 1994 (the "1994 Restructuring") which involved employees contributing $200,000,000 in new equity in return for receipt of entitlements to common shares. In addition, Aurora Airline Investments, Inc. ("Aurora"), a subsidiary of AMR Corporation ("AMR"), subscribed for $246,000,000 in preferred shares of CAIL. Other AMR subsidiaries entered into comprehensive services and marketing arrangements with CAIL. The governments of Canada, British Columbia and Alberta provided an aggregate of $120,000,000 in loan guarantees. Senior creditors, junior creditors and shareholders of CAC and CAIL and its subsidiaries converted approximately $712,000,000 of obligations into common shares of CAC or convertible notes issued jointly by CAC and CAIL and/or received warrants entitling the holder to purchase common shares.

11 In the latter half of 1994, Canadian built on the improved balance sheet provided by the 1994 Restructuring, focussing on strict cost controls, capacity management and aircraft utilization. The initial results were encouraging. However, a number of factors including higher than expected fuel costs, rising interest rates, decline of the Canadian

dollar, a strike by pilots of Time Air and the temporary grounding of Inter-Canadien's ATR-42 fleet undermined this improved operational performance. In 1995, in response to additional capacity added by emerging charter carriers and Air Canada on key transcontinental routes, CAIL added additional aircraft to its fleet in an effort to regain market share. However, the addition of capacity coincided with the slow-down in the Canadian economy leading to traffic levels that were significantly below expectations. Additionally, key international routes of CAIL failed to produce anticipated results. The cumulative losses of CAIL from 1994 to 1999 totalled $771 million and from January 31, 1995 to August 12, 1999, the day prior to the issuance by the Government of Canada of an Order under Section 47 of the *Canada Transportation Act* (relaxing certain rules under the *Competition Act* to facilitate a restructuring of the airline industry and described further below), the trading price of Canadian's common shares declined from $7.90 to $1.55.

12 Canadian's losses incurred since the 1994 Restructuring severely eroded its liquidity position. In 1996, Canadian faced an environment where the domestic air travel market saw increased capacity and aggressive price competition by two new discount carriers based in western Canada. While Canadian's traffic and load factor increased indicating a positive response to Canadian's post-restructuring business plan, yields declined. Attempts by Canadian to reduce domestic capacity were offset by additional capacity being introduced by the new discount carriers and Air Canada.

13 The continued lack of sufficient funds from operations made it evident by late fall of 1996 that Canadian needed to take action to avoid a cash shortfall in the spring of 1997. In November 1996, Canadian announced an operational restructuring plan (the "1996 Restructuring") aimed at returning Canadian to profitability and subsequently implemented a payment deferral plan which involved a temporary moratorium on payments to certain lenders and aircraft operating lessors to provide a cash bridge until the benefits of the operational restructuring were fully implemented. Canadian was able successfully to obtain the support of its lenders and operating lessors such that the moratorium and payment deferral plan was able to proceed on a consensual basis without the requirement for any court proceedings.

14 The objective of the 1996 Restructuring was to transform Canadian into a sustainable entity by focussing on controllable factors which targeted earnings improvements over four years. Three major initiatives were adopted: network enhancements, wage concessions as supplemented by fuel tax reductions/rebates, and overhead cost reductions.

15 The benefits of the 1996 Restructuring were reflected in Canadian's 1997 financial results when Canadian and its subsidiaries reported a consolidated net income of $5.4 million, the best results in 9 years.

16 In early 1998, building on its 1997 results, Canadian took advantage of a strong market for U.S. public debt financing in the first half of 1998 by issuing U.S. $175,000,000 of senior secured notes in April, 1998 ("Senior Secured Notes") and U.S. $100,000,000 of unsecured notes in August, 1998 ("Unsecured Notes").

17 The benefits of the 1996 Restructuring continued in 1998 but were not sufficient to offset a number of new factors which had a significant negative impact on financial performance, particularly in the fourth quarter. Canadian's eroded capital base gave it limited capacity to withstand negative effects on traffic and revenue. These factors included lower than expected operating revenues resulting from a continued weakness of the Asian economies, vigorous competition in Canadian's key western Canada and the western U.S. transborder markets, significant price discounting in most domestic markets following a labour disruption at Air Canada and CAIL's temporary loss of the ability to code-share with American Airlines on certain transborder flights due to a pilot dispute at American Airlines. Canadian also had increased operating expenses primarily due to the deterioration of the value of the Canadian dollar and additional airport and navigational fees imposed by NAV Canada which were not recoverable by Canadian through fare increases because of competitive pressures. This resulted in Canadian and its subsidiaries reporting a consolidated loss of $137.6 million for 1998.

18 As a result of these continuing weak financial results, Canadian undertook a number of additional strategic initiatives including entering the *oneworldTM* Alliance, the introduction of its new "Proud Wings" corporate image, a restructuring of CAIL's Vancouver hub, the sale and leaseback of certain aircraft, expanded code sharing arrangements and the implementation of a service charge in an effort to recover a portion of the costs relating to NAV Canada fees.

19 Beginning in late 1998 and continuing into 1999, Canadian tried to access equity markets to strengthen its balance sheet. In January, 1999, the Board of Directors of CAC determined that while Canadian needed to obtain additional equity capital, an equity infusion alone would not address the fundamental structural problems in the domestic air transportation market.

20 Canadian believes that its financial performance was and is reflective of structural problems in the Canadian airline industry, most significantly, over capacity in the domestic air transportation market. It is the view of Canadian and Air Canada that Canada's relatively small population and the geographic distribution of that population is unable to support the overlapping networks of two full service national carriers. As described further below, the Government of Canada has recognized this fundamental problem and has been instrumental in attempts to develop a solution.

Initial Discussions with Air Canada

21 Accordingly, in January, 1999, CAC's Board of Directors directed management to explore all strategic alternatives available to Canadian, including discussions regarding a possible merger or other transaction involving Air Canada.

22 Canadian had discussions with Air Canada in early 1999. AMR also participated in those discussions. While several alternative merger transactions were considered in the course of these discussions, Canadian, AMR and Air Canada were unable to reach agreement.

23 Following the termination of merger discussions between Canadian and Air Canada, senior management of Canadian, at the direction of the Board and with the support of AMR, renewed its efforts to secure financial partners with the objective of obtaining either an equity investment and support for an eventual merger with Air Canada or immediate financial support for a merger with Air Canada.

Offer by Onex

24 In early May, the discussions with Air Canada having failed, Canadian focussed its efforts on discussions with Onex Corporation ("Onex") and AMR concerning the basis upon which a merger of Canadian and Air Canada could be accomplished.

25 On August 23, 1999, Canadian entered into an Arrangement Agreement with Onex, AMR and Airline Industry Revitalization Co. Inc. ("AirCo") (a company owned jointly by Onex and AMR and controlled by Onex). The Arrangement Agreement set out the terms of a Plan of Arrangement providing for the purchase by AirCo of all of the outstanding common and non-voting shares of CAC. The Arrangement Agreement was conditional upon, among other things, the successful completion of a simultaneous offer by AirCo for all of the voting and non-voting shares of Air Canada. On August 24, 1999, AirCo announced its offers to purchase the shares of both CAC and Air Canada and to subsequently merge the operations of the two airlines to create one international carrier in Canada.

26 On or about September 20, 1999 the Board of Directors of Air Canada recommended against the AirCo offer. On or about October 19, 1999, Air Canada announced its own proposal to its shareholders to repurchase shares of Air Canada. Air Canada's announcement also indicated Air Canada's intention to make a bid for CAC and to proceed to complete a merger with Canadian subject to a restructuring of Canadian's debt.

27 There were several rounds of offers and counter-offers between AirCo and Air Canada. On November 5, 1999, the Quebec Superior Court ruled that the AirCo offer for Air Canada violated the provisions of the *Air Canada Public Participation Act*. AirCo immediately withdrew its offers. At that time, Air Canada indicated its intention to proceed with its offer for CAC.

28 Following the withdrawal of the AirCo offer to purchase CAC, and notwithstanding Air Canada's stated intention to proceed with its offer, there was a renewed uncertainty about Canadian's future which adversely affected operations.

As described further below, Canadian lost significant forward bookings which further reduced the company's remaining liquidity.

Offer by 853350

29 On November 11, 1999, 853350 (a corporation financed by Air Canada and owned as to 10% by Air Canada) made a formal offer for all of the common and non-voting shares of CAC. Air Canada indicated that the involvement of 853350 in the take-over bid was necessary in order to protect Air Canada from the potential adverse effects of a restructuring of Canadian's debt and that Air Canada would only complete a merger with Canadian after the completion of a debt restructuring transaction. The offer by 853350 was conditional upon, among other things, a satisfactory resolution of AMR's claims in respect of Canadian and a satisfactory resolution of certain regulatory issues arising from the announcement made on October 26, 1999 by the Government of Canada regarding its intentions to alter the regime governing the airline industry.

30 As noted above, AMR and its subsidiaries and affiliates had certain agreements with Canadian arising from AMR's investment (through its wholly owned subsidiary, Aurora Airline Investments, Inc.) in CAIL during the 1994 Restructuring. In particular, the Services Agreement by which AMR and its subsidiaries and affiliates provided certain reservations, scheduling and other airline related services to Canadian provided for a termination fee of approximately $500 million (as at December 31, 1999) while the terms governing the preferred shares issued to Aurora provided for exchange rights which were only retractable by Canadian upon payment of a redemption fee in excess of $500 million (as at December 31, 1999). Unless such provisions were amended or waived, it was practically impossible for Canadian to complete a merger with Air Canada since the cost of proceeding without AMR's consent was simply too high.

31 Canadian had continued its efforts to seek out all possible solutions to its structural problems following the withdrawal of the AirCo offer on November 5, 1999. While AMR indicated its willingness to provide a measure of support by allowing a deferral of some of the fees payable to AMR under the Services Agreement, Canadian was unable to find any investor willing to provide the liquidity necessary to keep Canadian operating while alternative solutions were sought.

32 After 853350 made its offer, 853350 and Air Canada entered into discussions with AMR regarding the purchase by 853350 of AMR's shareholding in CAIL as well as other matters regarding code sharing agreements and various services provided to Canadian by AMR and its subsidiaries and affiliates. The parties reached an agreement on November 22, 1999 pursuant to which AMR agreed to reduce its potential damages claim for termination of the Services Agreement by approximately 88%.

33 On December 4, 1999, CAC's Board recommended acceptance of 853350's offer to its shareholders and on December 21, 1999, two days before the offer closed, 853350 received approval for the offer from the Competition Bureau as well as clarification from the Government of Canada on the proposed regulatory framework for the Canadian airline industry.

34 As noted above, Canadian's financial condition deteriorated further after the collapse of the AirCo Arrangement transaction. In particular:

> a) the doubts which were publicly raised as to Canadian's ability to survive made Canadian's efforts to secure additional financing through various sale-leaseback transactions more difficult;
>
> b) sales for future air travel were down by approximately 10% compared to 1998;
>
> c) CAIL's liquidity position, which stood at approximately $84 million (consolidated cash and available credit) as at September 30, 1999, reached a critical point in late December, 1999 when it was about to go negative.

35 In late December, 1999, Air Canada agreed to enter into certain transactions designed to ensure that Canadian would have enough liquidity to continue operating until the scheduled completion of the 853350 take-over bid on January

4, 2000. Air Canada agreed to purchase rights to the Toronto-Tokyo route for $25 million and to a sale-leaseback arrangement involving certain unencumbered aircraft and a flight simulator for total proceeds of approximately $20 million. These transactions gave Canadian sufficient liquidity to continue operations through the holiday period.

36 If Air Canada had not provided the approximate $45 million injection in December 1999, Canadian would likely have had to file for bankruptcy and cease all operations before the end of the holiday travel season.

37 On January 4, 2000, with all conditions of its offer having been satisfied or waived, 853350 purchased approximately 82% of the outstanding shares of CAC. On January 5, 1999, 853350 completed the purchase of the preferred shares of CAIL owned by Aurora. In connection with that acquisition, Canadian agreed to certain amendments to the Services Agreement reducing the amounts payable to AMR in the event of a termination of such agreement and, in addition, the unanimous shareholders agreement which gave AMR the right to require Canadian to purchase the CAIL preferred shares under certain circumstances was terminated. These arrangements had the effect of substantially reducing the obstacles to a restructuring of Canadian's debt and lease obligations and also significantly reduced the claims that AMR would be entitled to advance in such a restructuring.

38 Despite the $45 million provided by Air Canada, Canadian's liquidity position remained poor. With January being a traditionally slow month in the airline industry, further bridge financing was required in order to ensure that Canadian would be able to operate while a debt restructuring transaction was being negotiated with creditors. Air Canada negotiated an arrangement with the Royal Bank of Canada ("Royal Bank") to purchase a participation interest in the operating credit facility made available to Canadian. As a result of this agreement, Royal Bank agreed to extend Canadian's operating credit facility from $70 million to $120 million in January, 2000 and then to $145 million in March, 2000. Canadian agreed to supplement the assignment of accounts receivable security originally securing Royal's $70 million facility with a further Security Agreement securing certain unencumbered assets of Canadian in consideration for this increased credit availability. Without the support of Air Canada or another financially sound entity, this increase in credit would not have been possible.

39 Air Canada has stated publicly that it ultimately wishes to merge the operations of Canadian and Air Canada, subject to Canadian completing a financial restructuring so as to permit Air Canada to complete the acquisition on a financially sound basis. This pre-condition has been emphasized by Air Canada since the fall of 1999.

40 Prior to the acquisition of majority control of CAC by 853350, Canadian's management, Board of Directors and financial advisors had considered every possible alternative for restoring Canadian to a sound financial footing. Based upon Canadian's extensive efforts over the past year in particular, but also the efforts since 1992 described above, Canadian came to the conclusion that it must complete a debt restructuring to permit the completion of a full merger between Canadian and Air Canada.

41 On February 1, 2000, Canadian announced a moratorium on payments to lessors and lenders. As a result of this moratorium Canadian defaulted on the payments due under its various credit facilities and aircraft leases. Absent the assistance provided by this moratorium, in addition to Air Canada's support, Canadian would not have had sufficient liquidity to continue operating until the completion of a debt restructuring.

42 Following implementation of the moratorium, Canadian with Air Canada embarked on efforts to restructure significant obligations by consent. The further damage to public confidence which a CCAA filing could produce required Canadian to secure a substantial measure of creditor support in advance of any public filing for court protection.

43 Before the Petitioners started these CCAA proceedings, Air Canada, CAIL and lessors of 59 aircraft in its fleet had reached agreement in principle on the restructuring plan.

44 Canadian and Air Canada have also been able to reach agreement with the remaining affected secured creditors, being the holders of the U.S. $175 million Senior Secured Notes, due 2005, (the "Senior Secured Noteholders") and with several major unsecured creditors in addition to AMR, such as Loyalty Management Group Canada Inc.

45 On March 24, 2000, faced with threatened proceedings by secured creditors, Canadian petitioned under the CCAA and obtained a stay of proceedings and related interim relief by Order of the Honourable Chief Justice Moore on that same date. Pursuant to that Order, PricewaterhouseCoopers, Inc. was appointed as the Monitor, and companion proceedings in the United States were authorized to be commenced.

46 Since that time, due to the assistance of Air Canada, Canadian has been able to complete the restructuring of the remaining financial obligations governing all aircraft to be retained by Canadian for future operations. These arrangements were approved by this Honourable Court in its Orders dated April 14, 2000 and May 10, 2000, as described in further detail below under the heading "The Restructuring Plan".

47 On April 7, 2000, this court granted an Order giving directions with respect to the filing of the plan, the calling and holding of meetings of affected creditors and related matters.

48 On April 25, 2000 in accordance with the said Order, Canadian filed and served the plan (in its original form) and the related notices and materials.

49 The plan was amended, in accordance with its terms, on several occasions, the form of Plan voted upon at the Creditors' Meetings on May 26, 2000 having been filed and served on May 25, 2000 (the "Plan").

The Restructuring Plan

50 The Plan has three principal aims described by Canadian:

(a) provide near term liquidity so that Canadian can sustain operations;

(b) allow for the return of aircraft not required by Canadian; and

(c) permanently adjust Canadian's debt structure and lease facilities to reflect the current market for asset values and carrying costs in return for Air Canada providing a guarantee of the restructured obligations.

51 The proposed treatment of stakeholders is as follows:

1. Unaffected Secured Creditors- Royal Bank, CAIL's operating lender, is an unaffected creditor with respect to its operating credit facility. Royal Bank holds security over CAIL's accounts receivable and most of CAIL's operating assets not specifically secured by aircraft financiers or the Senior Secured Noteholders. As noted above, arrangements entered into between Air Canada and Royal Bank have provided CAIL with liquidity necessary for it to continue operations since January 2000.

Also unaffected by the Plan are those aircraft lessors, conditional vendors and secured creditors holding security over CAIL's aircraft who have entered into agreements with CAIL and/or Air Canada with respect to the restructuring of CAIL's obligations. A number of such agreements, which were initially contained in the form of letters of intent ("LOIs"), were entered into prior to the commencement of the CCAA proceedings, while a total of 17 LOIs were completed after that date. In its Second and Fourth Reports the Monitor reported to the court on these agreements. The LOIs entered into after the proceedings commenced were reviewed and approved by the court on April 14, 2000 and May 10, 2000.

The basis of the LOIs with aircraft lessors was that the operating lease rates were reduced to fair market lease rates or less, and the obligations of CAIL under the leases were either assumed or guaranteed by Air Canada. Where the aircraft was subject to conditional sale agreements or other secured indebtedness, the value of the secured debt was reduced to the fair market value of the aircraft, and the interest rate payable was reduced to current market rates reflecting Air Canada's credit. CAIL's obligations under those agreements have also been assumed or guaranteed by Air Canada. The claims of these creditors for reduced principal and interest amounts, or reduced lease payments, are Affected Unsecured Claims under the Plan. In a number of cases these claims have been assigned to Air Canada and Air Canada disclosed that it would vote those claims in favour of the Plan.

2. Affected Secured Creditors- The Affected Secured Creditors under the Plan are the Senior Secured Noteholders with a claim in the amount of US$175,000,000. The Senior Secured Noteholders are secured by a diverse package of Canadian's assets, including its inventory of aircraft spare parts, ground equipment, spare engines, flight simulators, leasehold interests at Toronto, Vancouver and Calgary airports, the shares in CRAL 98 and a $53 million note payable by CRAL to CAIL.

The Plan offers the Senior Secured Noteholders payment of 97 cents on the dollar. The deficiency is included in the Affected Unsecured Creditor class and the Senior Secured Noteholders advised the court they would be voting the deficiency in favour of the Plan.

3. Unaffected Unsecured Creditors-In the circular accompanying the November 11, 1999 853350 offer it was stated that:

> The Offeror intends to conduct the Debt Restructuring in such a manner as to seek to ensure that the unionized employees of Canadian, the suppliers of new credit (including trade credit) and the members of the flying public are left unaffected.
>
> The Offeror is of the view that the pursuit of these three principles is essential in order to ensure that the long term value of Canadian is preserved.

Canadian's employees, customers and suppliers of goods and services are unaffected by the CCAA Order and Plan.

Also unaffected are parties to those contracts or agreements with Canadian which are not being terminated by Canadian pursuant to the terms of the March 24, 2000 Order.

4. Affected Unsecured Creditors- CAIL has identified unsecured creditors who do not fall into the above three groups and listed these as Affected Unsecured Creditors under the Plan. They are offered 14 cents on the dollar on their claims. Air Canada would fund this payment.

The Affected Unsecured Creditors fall into the following categories:

> a. Claims of holders of or related to the Unsecured Notes (the "Unsecured Noteholders");
>
> b. Claims in respect of certain outstanding or threatened litigation involving Canadian;
>
> c. Claims arising from the termination, breach or repudiation of certain contracts, leases or agreements to which Canadian is a party other than aircraft financing or lease arrangements;
>
> d. Claims in respect of deficiencies arising from the termination or re-negotiation of aircraft financing or lease arrangements;
>
> e. Claims of tax authorities against Canadian; and
>
> f. Claims in respect of the under-secured or unsecured portion of amounts due to the Senior Secured Noteholders.

52 There are over $700 million of proven unsecured claims. Some unsecured creditors have disputed the amounts of their claims for distribution purposes. These are in the process of determination by the court-appointed Claims Officer

and subject to further appeal to the court. If the Claims Officer were to allow all of the disputed claims in full and this were confirmed by the court, the aggregate of unsecured claims would be approximately $1.059 million.

53 The Monitor has concluded that if the Plan is not approved and implemented, Canadian will not be able to continue as a going concern and in that event, the only foreseeable alternative would be a liquidation of Canadian's assets by a receiver and/or a trustee in bankruptcy. Under the Plan, Canadian's obligations to parties essential to ongoing operations, including employees, customers, travel agents, fuel, maintenance and equipment suppliers, and airport authorities are in most cases to be treated as unaffected and paid in full. In the event of a liquidation, those parties would not, in most cases, be paid in full and, except for specific lien rights and statutory priorities, would rank as ordinary unsecured creditors. The Monitor estimates that the additional unsecured claims which would arise if Canadian were to cease operations as a going concern and be forced into liquidation would be in excess of $1.1 billion.

54 In connection with its assessment of the Plan, the Monitor performed a liquidation analysis of CAIL as at March 31, 2000 in order to estimate the amounts that might be recovered by CAIL's creditors and shareholders in the event of disposition of CAIL's assets by a receiver or trustee. The Monitor concluded that a liquidation would result in a shortfall to certain secured creditors, including the Senior Secured Noteholders, a recovery by ordinary unsecured creditors of between one cent and three cents on the dollar, and no recovery by shareholders.

55 There are two vociferous opponents of the Plan, Resurgence Asset Management LLC ("Resurgence") who acts on behalf of its and/or its affiliate client accounts and four shareholders of CAC. Resurgence is incorporated pursuant to the laws of New York, U.S.A. and has its head office in White Plains, New York. It conducts an investment business specializing in high yield distressed debt. Through a series of purchases of the Unsecured Notes commencing in April 1999, Resurgence clients hold $58,200,000 of the face value of or 58.2% of the notes issued. Resurgence purchased 7.9 million units in April 1999. From November 3, 1999 to December 9, 1999 it purchased an additional 20,850,000 units. From January 4, 2000 to February 3, 2000 Resurgence purchased an additional 29,450,000 units.

56 Resurgence seeks declarations that: the actions of Canadian, Air Canada and 853350 constitute an amalgamation, consolidation or merger with or into Air Canada or a conveyance or transfer of all or substantially all of Canadian's assets to Air Canada; that any plan of arrangement involving Canadian will not affect Resurgence and directing the repurchase of their notes pursuant to the provisions of their trust indenture and that the actions of Canadian, Air Canada and 853350 are oppressive and unfairly prejudicial to it pursuant to section 234 of the Business Corporations Act.

57 Four shareholders of CAC also oppose the plan. Neil Baker, a Toronto resident, acquired 132,500 common shares at a cost of $83,475.00 on or about May 5, 2000. Mr. Baker sought to commence proceedings to "remedy an injustice to the minority holders of the common shares". Roger Midiaty, Michael Salter and Hal Metheral are individual shareholders who were added as parties at their request during the proceedings. Mr. Midiaty resides in Calgary, Alberta and holds 827 CAC shares which he has held since 1994. Mr. Metheral is also a Calgary resident and holds approximately 14,900 CAC shares in his RRSP and has held them since approximately 1994 or 1995. Mr. Salter is a resident of Scottsdale, Arizona and is the beneficial owner of 250 shares of CAC and is a joint beneficial owner of 250 shares with his wife. These shareholders will be referred in the Decision throughout as the "Minority Shareholders".

58 The Minority Shareholders oppose the portion of the Plan that relates to the reorganization of CAIL, pursuant to section 185 of the *Alberta Business Corporations Act* ("ABCA"). They characterize the transaction as a cancellation of issued shares unauthorized by section 167 of the ABCA or alternatively is a violation of section 183 of the ABCA. They submit the application for the order of reorganization should be denied as being unlawful, unfair and not supported by the evidence.

III. Analysis

59 Section 6 of the CCAA provides that:

6. Where a majority in number representing two-thirds in value of the creditors, or class of creditors, as the case may be, present and voting either in person or by proxy at the meeting or meetings thereof respectively held pursuant to sections 4 and 5, or either of those sections, agree to any compromise or arrangement either as proposed or as altered or modified at the meeting or meetings, the compromise or arrangement may be sanctioned by the court, and if so sanctioned is binding

(a) on all the creditors or the class of creditors, as the case may be, and on any trustee for any such class of creditors, whether secured or unsecured, as the case may be, and on the company; and

(b) in the case of a company that has made an authorized assignment or against which a receiving order has been made under the Bankruptcy and Insolvency Act or is in the course of being wound up under the Winding-up and Restructuring Act, on the trustee in bankruptcy or liquidator and contributories of the company.

60 Prior to sanctioning a plan under the CCAA, the court must be satisfied in regard to each of the following criteria:

(1) there must be compliance with all statutory requirements;

(2) all material filed and procedures carried out must be examined to determine if anything has been done or purported to be done which is not authorized by the CCAA; and

(3) the plan must be fair and reasonable.

61 A leading articulation of this three-part test appears in *Re Northland Properties Ltd.* (1988), 73 C.B.R. (N.S.) 175 (B.C. S.C.) at 182-3, aff'd (1989), 73 C.B.R. (N.S.) 195 (B.C. C.A.) and has been regularly followed, see for example *Re Sammi Atlas Inc.* (1998), 3 C.B.R. (4th) 171 (Ont. Gen. Div. [Commercial List]) at 172 and *Re T. Eaton Co.* (1999), 15 C.B.R. (4th) 311 (Ont. S.C.J. [Commercial List]) at paragraph 7. Each of these criteria are reviewed in turn below.

1. Statutory Requirements

62 Some of the matters that may be considered by the court on an application for approval of a plan of compromise and arrangement include:

(a) the applicant comes within the definition of "debtor company" in section 2 of the CCAA;

(b) the applicant or affiliated debtor companies have total claims within the meaning of section 12 of the CCAA in excess of $5,000,000;

(c) the notice calling the meeting was sent in accordance with the order of the court;

(d) the creditors were properly classified;

(e) the meetings of creditors were properly constituted;

(f) the voting was properly carried out; and

(g) the plan was approved by the requisite double majority or majorities.

63 I find that the Petitioners have complied with all applicable statutory requirements. Specifically:

(a) CAC and CAIL are insolvent and thus each is a "debtor company" within the meaning of section 2 of the CCAA. This was established in the affidavit evidence of Douglas Carty, Senior Vice President and Chief Financial Officer of Canadian, and so declared in the March 24, 2000 Order in these proceedings and confirmed in the testimony given by Mr. Carty at this hearing.

(b) CAC and CAIL have total claims that would be claims provable in bankruptcy within the meaning of section 12 of the CCAA in excess of $5,000,000.

(c) In accordance with the April 7, 2000 Order of this court, a Notice of Meeting and a disclosure statement (which included copies of the Plan and the March 24th and April 7th Orders of this court) were sent to the Affected Creditors, the directors and officers of the Petitioners, the Monitor and persons who had served a Notice of Appearance, on April 25, 2000.

(d) As confirmed by the May 12, 2000 ruling of this court (leave to appeal denied May 29, 2000), the creditors have been properly classified.

(e) Further, as detailed in the Monitor's Fifth Report to the Court and confirmed by the June 14, 2000 decision of this court in respect of a challenge by Resurgence Asset Management LLC ("Resurgence"), the meetings of creditors were properly constituted, the voting was properly carried out and the Plan was approved by the requisite double majorities in each class. The composition of the majority of the unsecured creditor class is addressed below under the heading "Fair and Reasonable".

2. Matters Unauthorized

64 This criterion has not been widely discussed in the reported cases. As recognized by Blair J. in *Olympia & York Developments Ltd. v. Royal Trust Co.* (1993), 17 C.B.R. (3d) 1 (Ont. Gen. Div.) and Farley J. in *Re Cadillac Fairview Inc.* (February 6, 1995), Doc. B348/94 (Ont. Gen. Div. [Commercial List]), within the CCAA process the court must rely on the reports of the Monitor as well as the parties in ensuring nothing contrary to the CCAA has occurred or is contemplated by the plan.

65 In this proceeding, the dissenting groups have raised two matters which in their view are unauthorized by the CCAA: firstly, the Minority Shareholders of CAC suggested the proposed share capital reorganization of CAIL is illegal under the ABCA and Ontario Securities Commission Policy 9.1, and as such cannot be authorized under the CCAA and secondly, certain unsecured creditors suggested that the form of release contained in the Plan goes beyond the scope of release permitted under the CCAA.

a. Legality of proposed share capital reorganization

66 Subsection 185(2) of the ABCA provides:

(2) If a corporation is subject to an order for reorganization, its articles may be amended by the order to effect any change that might lawfully be made by an amendment under section 167.

67 Sections 6.1(2)(d) and (e) and Schedule "D" of the Plan contemplate that:

a. All CAIL common shares held by CAC will be converted into a single retractable share, which will then be retracted by CAIL for $1.00; and

b. All CAIL preferred shares held by 853350 will be converted into CAIL common shares.

68 The Articles of Reorganization in Schedule "D" to the Plan provide for the following amendments to CAIL's Articles of Incorporation to effect the proposed reorganization:

(a) consolidating all of the issued and outstanding common shares into one common share;

(b) redesignating the existing common shares as "Retractable Shares" and changing the rights, privileges, restrictions and conditions attaching to the Retractable Shares so that the Retractable Shares shall have attached thereto the rights, privileges, restrictions and conditions as set out in the Schedule of Share Capital;

(c) cancelling the Non-Voting Shares in the capital of the corporation, none of which are currently issued and outstanding, so that the corporation is no longer authorized to issue Non-Voting Shares;

(d) changing all of the issued and outstanding Class B Preferred Shares of the corporation into Class A Preferred Shares, on the basis of one (1) Class A Preferred Share for each one (1) Class B Preferred Share presently issued and outstanding;

(e) redesignating the existing Class A Preferred Shares as "Common Shares" and changing the rights, privileges, restrictions and conditions attaching to the Common Shares so that the Common Shares shall have attached thereto the rights, privileges, restrictions and conditions as set out in the Schedule of Share Capital; and

(f) cancelling the Class B Preferred Shares in the capital of the corporation, none of which are issued and outstanding after the change in paragraph (d) above, so that the corporation is no longer authorized to issue Class B Preferred Shares;

Section 167 of the ABCA

69 Reorganizations under section 185 of the ABCA are subject to two preconditions:

a. The corporation must be "subject to an order for re-organization"; and

b. The proposed amendments must otherwise be permitted under section 167 of the ABCA.

70 The parties agreed that an order of this court sanctioning the Plan would satisfy the first condition.

71 The relevant portions of section 167 provide as follows:

167(1) Subject to sections 170 and 171, the articles of a corporation may by special resolution be amended to

(e) change the designation of all or any of its shares, and add, change or remove any rights, privileges, restrictions and conditions, including rights to accrued dividends, in respect of all or any of its shares, whether issued or unissued,

(f) change the shares of any class or series, whether issued or unissued, into a different number of shares of the same class or series into the same or a different number of shares of other classes or series,

(g.1) cancel a class or series of shares where there are no issued or outstanding shares of that class or series,

72 Each change in the proposed CAIL Articles of Reorganization corresponds to changes permitted under s. 167(1) of the ABCA, as follows:

Proposed Amendment in Schedule "D"	**Subsection 167(1), ABCA**
(a) — consolidation of Common Shares	167(1)(f)
(b) — change of designation and rights	167(1)(e)
(c) — cancellation	167(1)(g.1)
(d) — change in shares	167(1)(f)
(e) — change of designation and rights	167(1)(e)
(f) — cancellation	167(1)(g.1)

73 The Minority Shareholders suggested that the proposed reorganization effectively cancels their shares in CAC. As the above review of the proposed reorganization demonstrates, that is not the case. Rather, the shares of CAIL are being consolidated, altered and then retracted, as permitted under section 167 of the ABCA. I find the proposed reorganization of CAIL's share capital under the Plan does not violate section 167.

74 In R. Dickerson et al, *Proposals for a New Business Corporation Law for Canada*, Vol.1: Commentary (the "Dickerson Report") regarding the then proposed Canada Business Corporations Act, the identical section to section 185 is described as having been inserted with the object of enabling the "court to effect any necessary amendment of the articles of the corporation in order to achieve the objective of the reorganization without having to comply with the formalities of the Draft Act, particularly shareholder approval of the proposed amendment".

75 The architects of the business corporation act model which the ABCA follows, expressly contemplated reorganizations in which the insolvent corporation would eliminate the interest of common shareholders. The example given in the Dickerson Report of a reorganization is very similar to that proposed in the Plan:

> For example, the reorganization of an insolvent corporation may require the following steps: first, reduction or even elimination of the interest of the common shareholders; second, relegation of the preferred shareholders to the status of common shareholders; and third, relegation of the secured debenture holders to the status of either unsecured Noteholders or preferred shareholders.

76 The rationale for allowing such a reorganization appears plain; the corporation is insolvent, which means that on liquidation the shareholders would get nothing. In those circumstances, as described further below under the heading "Fair and Reasonable", there is nothing unfair or unreasonable in the court effecting changes in such situations without shareholder approval. Indeed, it would be unfair to the creditors and other stakeholders to permit the shareholders (whose interest has the lowest priority) to have any ability to block a reorganization.

77 The Petitioners were unable to provide any case law addressing the use of section 185 as proposed under the Plan. They relied upon the decisions of *Re Royal Oak Mines Inc.* (1999), 14 C.B.R. (4th) 279 (Ont. S.C.J. [Commercial List]) and *T. Eaton Co.*, *supra* in which Farley J.of the Ontario Superior Court of Justice emphasized that shareholders are at the bottom of the hierarchy of interests in liquidation or liquidation related scenarios.

78 Section 185 provides for amendment to articles by court order. I see no requirement in that section for a meeting or vote of shareholders of CAIL, quite apart from shareholders of CAC. Further, dissent and appraisal rights are expressly removed in subsection (7). To require a meeting and vote of shareholders and to grant dissent and appraisal rights in circumstances of insolvency would frustrate the object of section 185 as described in the Dickerson Report.

79 In the circumstances of this case, where the majority shareholder holds 82% of the shares, the requirement of a special resolution is meaningless. To require a vote suggests the shares have value. They do not. The formalities of the ABCA serve no useful purpose other than to frustrate the reorganization to the detriment of all stakeholders, contrary to the CCAA.

Section 183 of the ABCA

80 The Minority Shareholders argued in the alternative that if the proposed share reorganization of CAIL were not a cancellation of their shares in CAC and therefore allowed under section 167 of the ABCA, it constituted a "sale, lease, or exchange of substantially all the property" of CAC and thus required the approval of CAC shareholders pursuant to section 183 of the ABCA. The Minority Shareholders suggested that the common shares in CAIL were substantially all of the assets of CAC and that all of those shares were being "exchanged" for $1.00.

81 I disagree with this creative characterization. The proposed transaction is a reorganization as contemplated by section 185 of the ABCA. As recognized in *Savage v. Amoco Acquisition Co.* (1988), 68 C.B.R. (N.S.) 154 (Alta. C.A.)

aff'd (1988), 70 C.B.R. (N.S.) xxxii (S.C.C.), the fact that the same end might be achieved under another section does not exclude the section to be relied on. A statute may well offer several alternatives to achieve a similar end.

Ontario Securities Commission Policy 9.1

82 The Minority Shareholders also submitted the proposed reorganization constitutes a "related party transaction" under Policy 9.1 of the Ontario Securities Commission. Under the Policy, transactions are subject to disclosure, minority approval and formal valuation requirements which have not been followed here. The Minority Shareholders suggested that the Petitioners were therefore in breach of the Policy unless and until such time as the court is advised of the relevant requirements of the Policy and grants its approval as provided by the Policy.

83 These shareholders asserted that in the absence of evidence of the going concern value of CAIL so as to determine whether that value exceeds the rights of the Preferred Shares of CAIL, the Court should not waive compliance with the Policy.

84 To the extent that this reorganization can be considered a "related party transaction", I have found, for the reasons discussed below under the heading "Fair and Reasonable", that the Plan, including the proposed reorganization, is fair and reasonable and accordingly I would waive the requirements of Policy 9.1.

b. Release

85 Resurgence argued that the release of directors and other third parties contained in the Plan does not comply with the provisions of the CCAA.

86 The release is contained in section 6.2(2)(ii) of the Plan and states as follows:

> As of the Effective Date, each of the Affected Creditors will be deemed to forever release, waive and discharge all claims, obligations, suits, judgments, damages, demands, debts, rights, causes of action and liabilities...that are based in whole or in part on any act, omission, transaction, event or other occurrence taking place on or prior to the Effective Date in any way relating to the Applicants and Subsidiaries, the CCAA Proceedings, or the Plan against: (i) The Applicants and Subsidiaries; (ii) The Directors, Officers and employees of the Applicants or Subsidiaries in each case as of the date of filing (and in addition, those who became Officers and/or Directors thereafter but prior to the Effective Date); (iii) The former Directors, Officers and employees of the Applicants or Subsidiaries, or (iv) the respective current and former professionals of the entities in subclauses (1) to (3) of this s.6.2(2) (including, for greater certainty, the Monitor, its counsel and its current Officers and Directors, and current and former Officers, Directors, employees, shareholders and professionals of the released parties) acting in such capacity.

87 Prior to 1997, the CCAA did not provide for compromises of claims against anyone other than the petitioning company. In 1997, section 5.1 was added to the CCAA. Section 5.1 states:

> 5.1 (1) A compromise or arrangement made in respect of a debtor company may include in its terms provision for the compromise of claims against directors of the company that arose before the commencement of proceedings under this Act and relate to the obligations of the company where the directors are by law liable in their capacity as directors for the payment of such obligations.
>
> (2) A provision for the compromise of claims against directors may not include claims that:
>
> > (a) relate to contractual rights of one or more creditors; or
> >
> > (b) are based on allegations of misrepresentations made by directors to creditors or of wrongful or oppressive conduct by directors.

(3) The Court may declare that a claim against directors shall not be compromised if it is satisfied that the compromise would not be fair and reasonable in the circumstances.

88 Resurgence argued that the form of release does not comply with section 5.1 of the CCAA insofar as it applies to individuals beyond directors and to a broad spectrum of claims beyond obligations of the Petitioners for which their directors are "by law liable". Resurgence submitted that the addition of section 5.1 to the CCAA constituted an exception to a long standing principle and urged the court to therefore interpret s. 5.1 cautiously, if not narrowly. Resurgence relied on *Crabtree (Succession de) c. Barrette*, [1993] 1 S.C.R. 1027 (S.C.C.) at 1044 and *Bruce Agra Foods Inc. v. Everfresh Beverages Inc. (Receiver of)* (1996), 45 C.B.R. (3d) 169 (Ont. Gen. Div.) at para. 5 in this regard.

89 With respect to Resurgence's complaint regarding the breadth of the claims covered by the release, the Petitioners asserted that the release is not intended to override section 5.1(2). Canadian suggested this can be expressly incorporated into the form of release by adding the words "*excluding the claims excepted by s. 5.1(2) of the CCAA*" immediately prior to subsection (iii) and clarifying the language in Section 5.1 of the Plan. Canadian also acknowledged, in response to a concern raised by Canada Customs and Revenue Agency, that in accordance with s. 5.1(1) of the CCAA, directors of CAC and CAIL could only be released from liability arising before March 24, 2000, the date these proceedings commenced. Canadian suggested this was also addressed in the proposed amendment. Canadian did not address the propriety of including individuals in addition to directors in the form of release.

90 In my view it is appropriate to amend the proposed release to expressly comply with section 5. 1(2) of the CCAA and to clarify Section 5.1 of the Plan as Canadian suggested in its brief. The additional language suggested by Canadian to achieve this result shall be included in the form of order. Canada Customs and Revenue Agency is apparently satisfied with the Petitioners' acknowledgement that claims against directors can only be released to the date of commencement of proceedings under the CCAA, having appeared at this hearing to strongly support the sanctioning of the Plan, so I will not address this concern further.

91 Resurgence argued that its claims fell within the categories of excepted claims in section 5.1(2) of the CCAA and accordingly, its concern in this regard is removed by this amendment. Unsecured creditors JHHD Aircraft Leasing No. 1 and No. 2 suggested there may be possible wrongdoing in the acts of the directors during the restructuring process which should not be immune from scrutiny and in my view this complaint would also be caught by the exception captured in the amendment.

92 While it is true that section 5.2 of the CCAA does not authorize a release of claims against third parties other than directors, it does not prohibit such releases either. The amended terms of the release will not prevent claims from which the CCAA expressly prohibits release. Aside from the complaints of Resurgence, which by their own submissions are addressed in the amendment I have directed, and the complaints of JHHD Aircraft Leasing No. 1 and No. 2, which would also be addressed in the amendment, the terms of the release have been accepted by the requisite majority of creditors and I am loathe to further disturb the terms of the Plan, with one exception.

93 Amex Bank of Canada submitted that the form of release appeared overly broad and might compromise unaffected claims of affected creditors. For further clarification, Amex Bank of Canada's potential claim for defamation is unaffected by the Plan and I am prepared to order Section 6.2(2)(ii) be amended to reflect this specific exception.

3. Fair and Reasonable

94 In determining whether to sanction a plan of arrangement under the CCAA, the court is guided by two fundamental concepts: "fairness" and "reasonableness". While these concepts are always at the heart of the court's exercise of its discretion, their meanings are necessarily shaped by the unique circumstances of each case, within the context of the Act and accordingly can be difficult to distill and challenging to apply. Blair J. described these concepts in *Olympia & York Developments Ltd. v. Royal Trust Co.*, *supra*, at page 9:

> "Fairness" and "reasonableness" are, in my opinion, the two keynote concepts underscoring the philosophy and workings of the Companies' Creditors Arrangement Act. Fairness is the quintessential expression of the court's equitable jurisdiction — although the jurisdiction is statutory, the broad discretionary powers given to the judiciary by the legislation which make its exercise an exercise in equity — and "reasonableness" is what lends objectivity to the process.

95 The legislation, while conferring broad discretion on the court, offers little guidance. However, the court is assisted in the exercise of its discretion by the purpose of the CCAA: to facilitate the reorganization of a debtor company for the benefit of the company, its creditors, shareholders, employees and, in many instances, a much broader constituency of affected persons. Parliament has recognized that reorganization, if commercially feasible, is in most cases preferable, economically and socially, to liquidation: *Norcen Energy Resources Ltd. v. Oakwood Petroleums Ltd.* (1988), [1989] 2 W.W.R. 566 (Alta. Q.B.) at 574; *Northland Properties Ltd. v. Excelsior Life Insurance Co. of Canada*, [1989] 3 W.W.R. 363 (B.C. C.A.) at 368.

96 The sanction of the court of a creditor-approved plan is not to be considered as a rubber stamp process. Although the majority vote that brings the plan to a sanction hearing plays a significant role in the court's assessment, the court will consider other matters as are appropriate in light of its discretion. In the unique circumstances of this case, it is appropriate to consider a number of additional matters:

a. The composition of the unsecured vote;

b. What creditors would receive on liquidation or bankruptcy as compared to the Plan;

c. Alternatives available to the Plan and bankruptcy;

d. Oppression;

e. Unfairness to Shareholders of CAC; and

f. The public interest.

a. Composition of the unsecured vote

97 As noted above, an important measure of whether a plan is fair and reasonable is the parties' approval and the degree to which it has been given. Creditor support creates an inference that the plan is fair and reasonable because the assenting creditors believe that their interests are treated equitably under the plan. Moreover, it creates an inference that the arrangement is economically feasible and therefore reasonable because the creditors are in a better position then the courts to gauge business risk. As stated by Blair J. at page 11 of *Olympia & York Developments Ltd.*, *supra*:

> As other courts have done, I observe that it is not my function to second guess the business people with respect to the "business" aspect of the Plan or descending into the negotiating arena or substituting my own view of what is a fair and reasonable compromise or arrangement for that of the business judgment of the participants. The parties themselves know best what is in their interests in those areas.

98 However, given the manner of voting under the CCAA, the court must be cognizant of the treatment of minorities within a class: see for example *Re Quintette Coal Ltd.* (1992), 13 C.B.R. (3d) 146 (B.C. S.C.) and *Re Alabama, New Orleans, Texas & Pacific Junction Railway* (1890), 60 L.J. Ch. 221 (Eng. C.A.). The court can address this by ensuring creditors' claims are properly classified. As well, it is sometimes appropriate to tabulate the vote of a particular class so the results can be assessed from a fairness perspective. In this case, the classification was challenged by Resurgence and I dismissed that application. The vote was also tabulated in this case and the results demonstrate that the votes of Air Canada and the Senior Secured Noteholders, who voted their deficiency in the unsecured class, were decisive.

99 The results of the unsecured vote, as reported by the Monitor, are:

> 1. For the resolution to approve the Plan: 73 votes (65% in number) representing $494,762,304 in claims (76% in value);
>
> 2. Against the resolution: 39 votes (35% in number) representing $156,360,363 in claims (24% in value); and
>
> 3. Abstentions: 15 representing $968,036 in value.

100 The voting results as reported by the Monitor were challenged by Resurgence. That application was dismissed.

101 The members of each class that vote in favour of a plan must do so in good faith and the majority within a class must act without coercion in their conduct toward the minority. When asked to assess fairness of an approved plan, the court will not countenance secret agreements to vote in favour of a plan secured by advantages to the creditor: see for example, *Hochberger v. Rittenberg* (1916), 36 D.L.R. 450 (S.C.C.)

102 In *Re Northland Properties Ltd.* (1988), 73 C.B.R. (N.S.) 175 (B.C. S.C.) at 192-3 aff'd (1989), 73 C.B.R. (N.S.) 195 (B.C. C.A.), dissenting priority mortgagees argued the plan violated the principle of equality due to an agreement between the debtor company and another priority mortgagee which essentially amounted to a preference in exchange for voting in favour of the plan. Trainor J. found that the agreement was freely disclosed and commercially reasonable and went on to approve the plan, using the three part test. The British Columbia Court of Appeal upheld this result and in commenting on the minority complaint McEachern J.A. stated at page 206:

> In my view, the obvious benefits of settling rights and keeping the enterprise together as a going concern far outweigh the deprivation of the appellants' wholly illusory rights. In this connection, the learned chambers judge said at p.29:
>
>> I turn to the question of the right to hold the property after an order absolute and whether or not this is a denial of something of that significance that it should affect these proceedings. There is in the material before me some evidence of values. There are the principles to which I have referred, as well as to the rights of majorities and the rights of minorities.
>>
>> Certainly, those minority rights are there, but it would seem to me that in view of the overall plan, in view of the speculative nature of holding property in the light of appraisals which have been given as to value, that this right is something which should be subsumed to the benefit of the majority.

103 Resurgence submitted that Air Canada manipulated the indebtedness of CAIL to assure itself of an affirmative vote. I disagree. I previously ruled on the validity of the deficiency when approving the LOIs and found the deficiency to be valid. I found there was consideration for the assignment of the deficiency claims of the various aircraft financiers to Air Canada, namely the provision of an Air Canada guarantee which would otherwise not have been available until plan sanction. The Monitor reviewed the calculations of the deficiencies and determined they were calculated in a reasonable manner. As such, the court approved those transactions. If the deficiency had instead remained with the aircraft financiers, it is reasonable to assume those claims would have been voted in favour of the plan. Further, it would have been entirely appropriate under the circumstances for the aircraft financiers to have retained the deficiency and agreed to vote in favour of the Plan, with the same result to Resurgence. That the financiers did not choose this method was explained by the testimony of Mr. Carty and Robert Peterson, Chief Financial Officer for Air Canada; quite simply it amounted to a desire on behalf of these creditors to shift the "deal risk" associated with the Plan to Air Canada. The agreement reached with the Senior Secured Noteholders was also disclosed and the challenge by Resurgence regarding their vote in the unsecured class was dismissed There is nothing inappropriate in the voting of the deficiency claims of Air Canada or the Senior Secured Noteholders in the unsecured class. There is no evidence of secret vote buying such as discussed in *Re Northland Properties Ltd.*

104 If the Plan is approved, Air Canada stands to profit in its operation. I do not accept that the deficiency claims were devised to dominate the vote of the unsecured creditor class, however, Air Canada, as funder of the Plan is more motivated than Resurgence to support it. This divergence of views on its own does not amount to bad faith on the part of Air Canada. Resurgence submitted that only the Unsecured Noteholders received 14 cents on the dollar. That is not accurate, as demonstrated by the list of affected unsecured creditors included earlier in these Reasons. The Senior Secured Noteholders did receive other consideration under the Plan, but to suggest they were differently motivated suggests that those creditors did not ascribe any value to their unsecured claims. There is no evidence to support this submission.

105 The good faith of Resurgence in its vote must also be considered. Resurgence acquired a substantial amount of its claim after the failure of the Onex bid, when it was aware that Canadian's financial condition was rapidly deteriorating. Thereafter, Resurgence continued to purchase a substantial amount of this highly distressed debt. While Mr. Symington maintained that he bought because he thought the bonds were a good investment, he also acknowledged that one basis for purchasing was the hope of obtaining a blocking position sufficient to veto a plan in the proposed debt restructuring. This was an obvious ploy for leverage with the Plan proponents

106 The authorities which address minority creditors' complaints speak of "substantial injustice" (*Re Keddy Motor Inns Ltd.* (1992), 13 C.B.R. (3d) 245 (N.S. C.A.), "confiscation" of rights (*Re Campeau Corp.* (1992), 10 C.B.R. (3d) 104 (Ont. Gen. Div.); *Re SkyDome Corp.* (March 21, 1999), Doc. 98-CL-3179 (Ont. Gen. Div. [Commercial List])) and majorities "feasting upon" the rights of the minority (*Re Quintette Coal Ltd.* (1992), 13 C.B.R. (3d) 146 (B.C. S.C.). Although it cannot be disputed that the group of Unsecured Noteholders represented by Resurgence are being asked to accept a significant reduction of their claims, as are all of the affected unsecured creditors, I do not see a "substantial injustice", nor view their rights as having been "confiscated" or "feasted upon" by being required to succumb to the wishes of the majority in their class. No bad faith has been demonstrated in this case. Rather, the treatment of Resurgence, along with all other affected unsecured creditors, represents a reasonable balancing of interests. While the court is directed to consider whether there is an injustice being worked within a class, it must also determine whether there is an injustice with respect the stakeholders as a whole. Even if a plan might at first blush appear to have that effect, when viewed in relation to all other parties, it may nonetheless be considered appropriate and be approved: *Algoma Steel Corp. v. Royal Bank* (1992), 11 C.B.R. (3d) 1 (Ont. Gen. Div.) and *Re Northland Properties Ltd.*, *supra* at 9.

107 Further, to the extent that greater or discrete motivation to support a Plan may be seen as a conflict, the Court should take this same approach and look at the creditors as a whole and to the objecting creditors specifically and determine if their rights are compromised in an attempt to balance interests and have the pain of compromise borne equally.

108 Resurgence represents 58.2% of the Unsecured Noteholders or $96 million in claims. The total claim of the Unsecured Noteholders ranges from $146 million to $161 million. The affected unsecured class, excluding aircraft financing, tax claims, the noteholders and claims under $50,000, ranges from $116.3 million to $449.7 million depending on the resolutions of certain claims by the Claims Officer. Resurgence represents between 15.7% - 35% of that portion of the class.

109 The total affected unsecured claims, excluding tax claims, but including aircraft financing and noteholder claims including the unsecured portion of the Senior Secured Notes, ranges from $673 million to $1,007 million. Resurgence represents between 9.5% - 14.3% of the total affected unsecured creditor pool. These percentages indicate that at its very highest in a class excluding Air Canada's assigned claims and Senior Secured's deficiency, Resurgence would only represent a maximum of 35% of the class. In the larger class of affected unsecured it is significantly less. Viewed in relation to the class as a whole, there is no injustice being worked against Resurgence.

110 The thrust of the Resurgence submissions suggests a mistaken belief that they will get more than 14 cents on liquidation. This is not borne out by the evidence and is not reasonable in the context of the overall Plan.

b. Receipts on liquidation or bankruptcy

111 As noted above, the Monitor prepared and circulated a report on the Plan which contained a summary of a liquidation analysis outlining the Monitor's projected realizations upon a liquidation of CAIL ("Liquidation Analysis").

112 The Liquidation Analysis was based on: (1) the draft unaudited financial statements of Canadian at March 31, 2000; (2) the distress values reported in independent appraisals of aircraft and aircraft related assets obtained by CAIL in January, 2000; (3) a review of CAIL's aircraft leasing and financing documents; and (4) discussions with CAIL Management.

113 Prior to and during the application for sanction, the Monitor responded to various requests for information by parties involved. In particular, the Monitor provided a copy of the Liquidation Analysis to those who requested it. Certain of the parties involved requested the opportunity to question the Monitor further, particularly in respect to the Liquidation Analysis and this court directed a process for the posing of those questions.

114 While there were numerous questions to which the Monitor was asked to respond, there were several areas in which Resurgence and the Minority Shareholders took particular issue: pension plan surplus, CRAL, international routes and tax pools. The dissenting groups asserted that these assets represented overlooked value to the company on a liquidation basis or on a going concern basis.

Pension Plan Surplus

115 The Monitor did not attribute any value to pension plan surplus when it prepared the Liquidation Analysis, for the following reasons:

> 1) The summaries of the solvency surplus/deficit positions indicated a cumulative net deficit position for the seven registered plans, after consideration of contingent liabilities;
>
> 2) The possibility, based on the previous splitting out of the seven plans from a single plan in 1988, that the plans could be held to be consolidated for financial purposes, which would remove any potential solvency surplus since the total estimated contingent liabilities exceeded the total estimated solvency surplus;
>
> 3) The actual calculations were prepared by CAIL's actuaries and actuaries representing the unions could conclude liabilities were greater; and
>
> 4) CAIL did not have a legal opinion confirming that surpluses belonged to CAIL.

116 The Monitor concluded that the entitlement question would most probably have to be settled by negotiation and/or litigation by the parties. For those reasons, the Monitor took a conservative view and did not attribute an asset value to pension plans in the Liquidation Analysis. The Monitor also did not include in the Liquidation Analysis any amount in respect of the claim that could be made by members of the plan where there is an apparent deficit after deducting contingent liabilities.

117 The issues in connection with possible pension surplus are: (1) the true amount of any of the available surplus; and (2) the entitlement of Canadian to any such amount.

118 It is acknowledged that surplus prior to termination can be accessed through employer contribution holidays, which Canadian has taken to the full extent permitted. However, there is no basis that has been established for any surplus being available to be withdrawn from an ongoing pension plan. On a pension plan termination, the amount available as a solvency surplus would first have to be further reduced by various amounts to determine whether there was in fact any true surplus available for distribution. Such reductions include contingent benefits payable in accordance with

the provisions of each respective pension plan, any extraordinary plan wind up cost, the amounts of any contribution holidays taken which have not been reflected, and any litigation costs.

119 Counsel for all of Canadian's unionized employees confirmed on the record that the respective union representatives can be expected to dispute all of these calculations as well as to dispute entitlement.

120 There is a suggestion that there might be a total of $40 million of surplus remaining from all pension plans after such reductions are taken into account. Apart from the issue of entitlement, this assumes that the plans can be treated separately, that a surplus could in fact be realized on liquidation and that the Towers Perrin calculations are not challenged. With total pension plan assets of over $2 billion, a surplus of $40 million could quickly disappear with relatively minor changes in the market value of the securities held or calculation of liabilities. In the circumstances, given all the variables, I find that the existence of any surplus is doubtful at best and I am satisfied that the Monitor's Liquidation Analysis ascribing it zero value is reasonable in this circumstances.

CRAL

121 The Monitor's liquidation analysis as at March 31, 2000 of CRAL determined that in a distress situation, after payments were made to its creditors, there would be a deficiency of approximately $30 million to pay Canadian Regional's unsecured creditors, which include a claim of approximately $56.5 million due to Canadian. In arriving at this conclusion, the Monitor reviewed internally prepared unaudited financial statements of CRAL as of March 31, 2000, the Houlihan Lokey Howard and Zukin, distress valuation dated January 21, 2000 and the Simat Helliesen and Eichner valuation of selected CAIL assets dated January 31, 2000 for certain aircraft related materials and engines, rotables and spares. The Avitas Inc., and Avmark Inc. reports were used for the distress values on CRAL's aircraft and the CRAL aircraft lease documentation. The Monitor also performed its own analysis of CRAL's liquidation value, which involved analysis of the reports provided and details of its analysis were outlined in the Liquidation Analysis.

122 For the purpose of the Liquidation Analysis, the Monitor did not consider other airlines as comparable for evaluation purposes, as the Monitor's valuation was performed on a distressed sale basis. The Monitor further assumed that without CAIL's national and international network to feed traffic into and a source of standby financing, and considering the inevitable negative publicity which a failure of CAIL would produce, CRAL would immediately stop operations as well.

123 Mr. Peterson testified that CRAL was worth $260 million to Air Canada, based on Air Canada being a special buyer who could integrate CRAL, on a going concern basis, into its network. The Liquidation Analysis assumed the windup of each of CRAL and CAIL, a completely different scenario.

124 There is no evidence that there was a potential purchaser for CRAL who would be prepared to acquire CRAL or the operations of CRAL 98 for any significant sum or at all. CRAL has value to CAIL, and in turn, could provide value to Air Canada, but this value is attributable to its ability to feed traffic to and take traffic from the national and international service operated by CAIL. In my view, the Monitor was aware of these features and properly considered these factors in assessing the value of CRAL on a liquidation of CAIL.

125 If CAIL were to cease operations, the evidence is clear that CRAL would be obliged to do so as well immediately. The travelling public, shippers, trade suppliers, and others would make no distinction between CAIL and CRAL and there would be no going concern for Air Canada to acquire.

International Routes

126 The Monitor ascribed no value to Canadian's international routes in the Liquidation Analysis. In discussions with CAIL management and experts available in its aviation group, the Monitor was advised that international routes are unassignable licenses and not property rights. They do not appear as assets in CAIL's financials. Mr. Carty and Mr. Peterson explained that routes and slots are *not* treated as assets by airlines, but rather as rights in the control of the

Government of Canada. In the event of bankruptcy/receivership of CAIL, CAIL's trustee/receiver could not sell them and accordingly they are of no value to CAIL.

127 Evidence was led that on June 23, 1999 Air Canada made an offer to purchase CAIL's international routes for $400 million cash plus $125 million for aircraft spares and inventory, along with the assumption of certain debt and lease obligations for the aircraft required for the international routes. CAIL evaluated the Air Canada offer and concluded that the proposed purchase price was insufficient to permit it to continue carrying on business in the absence of its international routes. Mr. Carty testified that something in the range of $2 billion would be required.

128 CAIL was in desperate need of cash in mid December, 1999. CAIL agreed to sell its Toronto — Tokyo route for $25 million. The evidence, however, indicated that the price for the Toronto — Tokyo route was not derived from a valuation, but rather was what CAIL asked for, based on its then-current cash flow requirements. Air Canada and CAIL obtained Government approval for the transfer on December 21, 2000.

129 Resurgence complained that despite this evidence of offers for purchase and actual sales of international routes and other evidence of sales of slots, the Monitor did not include Canadian's international routes in the Liquidation Analysis and only attributed a total of $66 million for all intangibles of Canadian. There is some evidence that slots at some foreign airports may be bought or sold in some fashion. However, there is insufficient evidence to attribute any value to other slots which CAIL has at foreign airports. It would appear given the regulation of the airline industry, in particular, the *Aeronautics Act* and the *Canada Transportation Act*, that international routes for a Canadian air carrier only have full value to the extent of federal government support for the transfer or sale, and its preparedness to allow the then-current license holder to sell rather than act unilaterally to change the designation. The federal government was prepared to allow CAIL to sell its Toronto — Tokyo route to Air Canada in light of CAIL's severe financial difficulty and the certainty of cessation of operations during the Christmas holiday season in the absence of such a sale.

130 Further, statements made by CAIL in mid-1999 as to the value of its international routes and operations in response to an offer by Air Canada, reflected the amount CAIL needed to sustain liquidity without its international routes and was not a representation of market value of what could realistically be obtained from an arms length purchaser. The Monitor concluded on its investigation that CAIL's Narida and Heathrow slots had a realizable value of $66 million, which it included in the Liquidation Analysis. I find that this conclusion is supportable and that the Monitor properly concluded that there were no other rights which ought to have been assigned value.

Tax Pools

131 There are four tax pools identified by Resurgence and the Minority Shareholders that are material: capital losses at the CAC level, undepreciated capital cost pools, operating losses incurred by Canadian and potential for losses to be reinstated upon repayment of fuel tax rebates by CAIL.

Capital Loss Pools

132 The capital loss pools at CAC will not be available to Air Canada since CAC is to be left out of the corporate reorganization and will be severed from CAIL. Those capital losses can essentially only be used to absorb a portion of the debt forgiveness liability associated with the restructuring. CAC, who has virtually all of its senior debt compromised in the plan, receives compensation for this small advantage, which cost them nothing.

Undepreciated capital cost ("UCC")

133 There is no benefit to Air Canada in the pools of UCC unless it were established that the UCC pools are in excess of the fair market value of the relevant assets, since Air Canada could create the same pools by simply buying the assets on a liquidation at fair market value. Mr. Peterson understood this pool of UCC to be approximately $700 million. There is no evidence that the UCC pool, however, could be considered to be a source of benefit. There is no evidence that this amount is any greater than fair market value.

Operating Losses

134 The third tax pool complained of is the operating losses. The debt forgiven as a result of the Plan will erase any operating losses from prior years to the extent of such forgiven debt.

Fuel tax rebates

135 The fourth tax pool relates to the fuel tax rebates system taken advantage of by CAIL in past years. The evidence is that on a consolidated basis the total potential amount of this pool is $297 million. According to Mr. Carty's testimony, CAIL has not been taxable in his ten years as Chief Financial Officer. The losses which it has generated for tax purposes have been sold on a 10 - 1 basis to the government in order to receive rebates of excise tax paid for fuel. The losses can be restored retroactively if the rebates are repaid, but the losses can only be carried forward for a maximum of seven years. The evidence of Mr. Peterson indicates that Air Canada has no plan to use those alleged losses and in order for them to be useful to Air Canada, Air Canada would have to complete a legal merger with CAIL, which is not provided for in the plan and is not contemplated by Air Canada until some uncertain future date. In my view, the Monitor's conclusion that there was no value to any tax pools in the Liquidation Analysis is sound.

136 Those opposed to the Plan have raised the spectre that there may be value unaccounted for in this liquidation analysis or otherwise. Given the findings above, this is merely speculation and is unsupported by any concrete evidence.

c. Alternatives to the Plan

137 When presented with a plan, affected stakeholders must weigh their options in the light of commercial reality. Those options are typically liquidation measured against the plan proposed. If not put forward, a hope for a different or more favourable plan is not an option and no basis upon which to assess fairness. On a purposive approach to the CCAA, what is fair and reasonable must be assessed against the effect of the Plan on the creditors and their various claims, in the context of their response to the plan. Stakeholders are expected to decide their fate based on realistic, commercially viable alternatives (generally seen as the prime motivating factor in any business decision) and not on speculative desires or hope for the future. As Farley J. stated in *T. Eaton Co.* (1999), 15 C.B.R. (4th) 311 (Ont. S.C.J. [Commercial List]) at paragraph 6:

> One has to be cognizant of the function of a balancing of their prejudices. Positions must be realistically assessed and weighed, all in the light of what an alternative to a successful plan would be. Wishes are not a firm foundation on which to build a plan; nor are ransom demands.

138 The evidence is overwhelming that all other options have been exhausted and have resulted in failure. The concern of those opposed suggests that there is a better plan that Air Canada can put forward. I note that significant enhancements were made to the plan during the process. In any case, this is the Plan that has been voted on. The evidence makes it clear that there is not another plan forthcoming. As noted by Farley J. in *T. Eaton Co.*, *supra*, "no one presented an alternative plan for the interested parties to vote on" (para. 8).

d. Oppression

Oppression and the CCAA

139 Resurgence and the Minority Shareholders originally claimed that the Plan proponents, CAC and CAIL and the Plan supporters 853350 and Air Canada had oppressed, unfairly disregarded or unfairly prejudiced their interests, under Section 234 of the ABCA. The Minority Shareholders (for reasons that will appear obvious) have abandoned that position.

140 Section 234 gives the court wide discretion to remedy corporate conduct that is unfair. As remedial legislation, it attempts to balance the interests of shareholders, creditors and management to ensure adequate investor protection and

maximum management flexibility. The Act requires the court to judge the conduct of the company and the majority in the context of equity and fairness: *First Edmonton Place Ltd. v. 315888 Alberta Ltd.* (1988), 40 B.L.R. 28 (Alta. Q.B.). Equity and fairness are measured against or considered in the context of the rights, interests or reasonable expectations of the complainants: *Diligenti v. RWMD Operations Kelowna Ltd.* (1976), 1 B.C.L.R. 36 (B.C. S.C.).

141 The starting point in any determination of oppression requires an understanding as to what the rights, interests, and reasonable expectations are and what the damaging or detrimental effect is on them. MacDonald J. stated in *First Edmonton Place*, *supra* at 57:

> In deciding what is unfair, the history and nature of the corporation, the essential nature of the relationship between the corporation and the creditor, the type of rights affected in general commercial practice should all be material. More concretely, the test of unfair prejudice or unfair disregard should encompass the following considerations: The protection of the underlying expectation of a creditor in the arrangement with the corporation, the extent to which the acts complained of were unforeseeable where the creditor could not reasonably have protected itself from such acts and the detriment to the interests of the creditor.

142 While expectations vary considerably with the size, structure, and value of the corporation, all expectations must be reasonably and objectively assessed: *Pente Investment Management Ltd. v. Schneider Corp.* (1998), 42 O.R. (3d) 177 (Ont. C.A.).

143 Where a company is insolvent, only the creditors maintain a meaningful stake in its assets. Through the mechanism of liquidation or insolvency legislation, the interests of shareholders are pushed to the bottom rung of the priority ladder. The expectations of creditors and shareholders must be viewed and measured against an altered financial and legal landscape. Shareholders cannot reasonably expect to maintain a financial interest in an insolvent company where creditors' claims are not being paid in full. It is through the lens of insolvency that the court must consider whether the acts of the company are in fact oppressive, unfairly prejudicial or unfairly disregarded. CCAA proceedings have recognized that shareholders may not have "a true interest to be protected" because there is no reasonable prospect of economic value to be realized by the shareholders given the existing financial misfortunes of the company: *Royal Oak Mines Ltd.*, *supra*, para. 4., *Re Cadillac Fairview Inc.* (March 7, 1995), Doc. B28/95 (Ont. Gen. Div. [Commercial List]), and *T. Eaton Company*, *supra*.

144 To avail itself of the protection of the CCAA, a company must be insolvent. The CCAA considers the hierarchy of interests and assesses fairness and reasonableness in that context. The court's mandate not to sanction a plan in the absence of fairness necessitates the determination as to whether the complaints of dissenting creditors and shareholders are legitimate, bearing in mind the company's financial state. The articulated purpose of the Act and the jurisprudence interpreting it, "widens the lens" to balance a broader range of interests that includes creditors and shareholders and beyond to the company, the employees and the public, and tests the fairness of the plan with reference to its impact on all of the constituents.

145 It is through the lens of insolvency legislation that the rights and interests of both shareholders and creditors must be considered. The reduction or elimination of rights of both groups is a function of the insolvency and not of oppressive conduct in the operation of the CCAA. The antithesis of oppression is fairness, the guiding test for judicial sanction. If a plan unfairly disregards or is unfairly prejudicial it will not be approved. However, the court retains the power to compromise or prejudice rights to effect a broader purpose, the restructuring of an insolvent company, provided that the plan does so in a fair manner.

Oppression allegations by Resurgence

146 Resurgence alleges that it has been oppressed or had its rights disregarded because the Petitioners and Air Canada disregarded the specific provisions of their trust indenture, that Air Canada and 853350 dealt with other creditors outside of the CCAA, refusing to negotiate with Resurgence and that they are generally being treated inequitably under the Plan.

147 The trust indenture under which the Unsecured Notes were issued required that upon a "change of control", 101% of the principal owing thereunder, plus interest would be immediately due and payable. Resurgence alleges that Air Canada, through 853350, caused CAC and CAIL to purposely fail to honour this term. Canadian acknowledges that the trust indenture was breached. On February 1, 2000, Canadian announced a moratorium on payments to lessors and lenders, including the Unsecured Noteholders. As a result of this moratorium, Canadian defaulted on the payments due under its various credit facilities and aircraft leases.

148 The moratorium was not directed solely at the Unsecured Noteholders. It had the same impact on other creditors, secured and unsecured. Canadian, as a result of the moratorium, breached other contractual relationships with various creditors. The breach of contract is not sufficient to found a claim for oppression in this case. Given Canadian's insolvency, which Resurgence recognized, it cannot be said that there was a reasonable expectation that it would be paid in full under the terms of the trust indenture, particularly when Canadian had ceased making payments to other creditors as well.

149 It is asserted that because the Plan proponents engaged in a restructuring of Canadian's debt before the filing under the CCAA, that its use of the Act for only a small group of creditors, which includes Resurgence is somehow oppressive.

150 At the outset, it cannot be overlooked that the CCAA does not require that a compromise be proposed to *all* creditors of an insolvent company. The CCAA is a flexible, remedial statute which recognizes the unique circumstances that lead to and away from insolvency.

151 Next, Air Canada made it clear beginning in the fall of 1999 that Canadian would have to complete a financial restructuring so as to permit Air Canada to acquire CAIL on a financially sound basis and as a wholly owned subsidiary. Following the implementation of the moratorium, absent which Canadian could not have continued to operate, Canadian and Air Canada commenced efforts to restructure significant obligations by consent. They perceived that further damage to public confidence that a CCAA filing could produce, required Canadian to secure a substantial measure of creditor support in advance of any public filing for court protection. Before the Petitioners started the CCAA proceedings on March 24, 2000, Air Canada, CAIL and lessors of 59 aircraft in its fleet had reached agreement in principle on the restructuring plan.

152 The purpose of the CCAA is to create an environment for negotiations and compromise. Often it is the stay of proceedings that creates the necessary stability for that process to unfold. Negotiations with certain key creditors in advance of the CCAA filing, rather than being oppressive or conspiratorial, are to be encouraged as a matter of principle if their impact is to provide a firm foundation for a restructuring. Certainly in this case, they were of critical importance, staving off liquidation, preserving cash flow and allowing the Plan to proceed. Rather than being detrimental or prejudicial to the interests of the other stakeholders, including Resurgence, it was beneficial to Canadian and all of its stakeholders.

153 Resurgence complained that certain transfers of assets to Air Canada and its actions in consolidating the operations of the two entities prior to the initiation of the CCAA proceedings were unfairly prejudicial to it.

154 The evidence demonstrates that the sales of the Toronto — Tokyo route, the Dash 8s and the simulators were at the suggestion of Canadian, who was in desperate need of operating cash. Air Canada paid what Canadian asked, based on its cash flow requirements. The evidence established that absent the injection of cash at that critical juncture, Canadian would have ceased operations. It is for that reason that the Government of Canada willingly provided the approval for the transfer on December 21, 2000.

155 Similarly, the renegotiation of CAIL's aircraft leases to reflect market rates supported by Air Canada covenant or guarantee has been previously dealt with by this court and found to have been in the best interest of Canadian, not to its detriment. The evidence establishes that the financial support and corporate integration that has been provided by Air Canada was not only in Canadian's best interest, but its only option for survival. The suggestion that the renegotiations

of these leases, various sales and the operational realignment represents an assumption of a benefit by Air Canada to the detriment of Canadian is not supported by the evidence.

156 I find the transactions predating the CCAA proceedings, were in fact Canadian's life blood in ensuring some degree of liquidity and stability within which to conduct an orderly restructuring of its debt. There was no detriment to Canadian or to its creditors, including its unsecured creditors. That Air Canada and Canadian were so successful in negotiating agreements with their major creditors, including aircraft financiers, without resorting to a stay under the CCAA underscores the serious distress Canadian was in and its lenders recognition of the viability of the proposed Plan.

157 Resurgence complained that other significant groups held negotiations with Canadian. The evidence indicates that a meeting was held with Mr. Symington, Managing Director of Resurgence, in Toronto in March 2000. It was made clear to Resurgence that the pool of unsecured creditors would be somewhere between $500 and $700 million and that Resurgence would be included within that class. To the extent that the versions of this meeting differ, I prefer and accept the evidence of Mr. Carty. Resurgence wished to play a significant role in the debt restructuring and indicated it was prepared to utilize the litigation process to achieve a satisfactory result for itself. It is therefore understandable that no further negotiations took place. Nevertheless, the original offer to affected unsecured creditors has been enhanced since the filing of the plan on April 25, 2000. The enhancements to unsecured claims involved the removal of the cap on the unsecured pool and an increase from 12 to 14 cents on the dollar.

158 The findings of the Commissioner of Competition establishes beyond doubt that absent the financial support provided by Air Canada, Canadian would have failed in December 1999. I am unable to find on the evidence that Resurgence has been oppressed. The complaint that Air Canada has plundered Canadian and robbed it of its assets is not supported but contradicted by the evidence. As described above, the alternative is liquidation and in that event the Unsecured Noteholders would receive between one and three cents on the dollar. The Monitor's conclusions in this regard are supportable and I accept them.

e. Unfairness to Shareholders

159 The Minority Shareholders essentially complained that they were being unfairly stripped of their only asset in CAC — the shares of CAIL. They suggested they were being squeezed out by the new CAC majority shareholder 853350, without any compensation or any vote. When the reorganization is completed as contemplated by the Plan, their shares will remain in CAC but CAC will be a bare shell.

160 They further submitted that Air Canada's cash infusion, the covenants and guarantees it has offered to aircraft financiers, and the operational changes (including integration of schedules, "quick win" strategies, and code sharing) have all added significant value to CAIL to the benefit of its stakeholders, including the Minority Shareholders. They argued that they should be entitled to continue to participate into the future and that such an expectation is legitimate and consistent with the statements and actions of Air Canada in regard to integration. By acting to realign the airlines before a corporate reorganization, the Minority Shareholders asserted that Air Canada has created the expectation that it is prepared to consolidate the airlines with the participation of a minority. The Minority Shareholders take no position with respect to the debt restructuring under the CCAA, but ask the court to sever the corporate reorganization provisions contained in the Plan.

161 Finally, they asserted that CAIL has increased in value due to Air Canada's financial contributions and operational changes and that accordingly, before authorizing the transfer of the CAIL shares to 853350, the current holders of the CAIL Preferred Shares, the court must have evidence before it to justify a transfer of 100% of the equity of CAIL to the Preferred Shares.

162 That CAC will have its shareholding in CAIL extinguished and emerge a bare shell is acknowledged. However, the evidence makes it abundantly clear that those shares, CAC's "only asset", have no value. That the Minority Shareholders

are content to have the debt restructuring proceed suggests by implication that they do not dispute the insolvency of both Petitioners, CAC and CAIL.

163 The Minority Shareholders base their expectation to remain as shareholders on the actions of Air Canada in acquiring only 82% of the CAC shares before integrating certain of the airlines' operations. Mr. Baker (who purchased *after* the Plan was filed with the Court and almost six months after the take over bid by Air Canada) suggested that the contents of the bid circular misrepresented Air Canada's future intentions to its shareholders. The two dollar price offered and paid per share in the bid must be viewed somewhat skeptically and in the context in which the bid arose. It does not support the speculative view that some shareholders hold, that somehow, despite insolvency, their shares have some value on a going concern basis. In any event, any claim for misrepresentation that Minority Shareholders might have arising from the take over bid circular against Air Canada or 853350, if any, is unaffected by the Plan and may be pursued after the stay is lifted.

164 In considering Resurgence's claim of oppression I have already found that the financial support of Air Canada during this restructuring period has benefited Canadian and its stakeholders. Air Canada's financial support and the integration of the two airlines has been critical to keeping Canadian afloat. The evidence makes it abundantly clear that without this support Canadian would have ceased operations. However it has not transformed CAIL or CAC into solvent companies.

165 The Minority Shareholders raise concerns about assets that are ascribed limited or no value in the Monitor's report as does Resurgence (although to support an opposite proposition). Considerable argument was directed to the future operational savings and profitability forecasted for Air Canada, its subsidiaries and CAIL and its subsidiaries. Mr. Peterson estimated it to be in the order of $650 to $800 million on an annual basis, commencing in 2001. The Minority Shareholders point to the tax pools of a restructured company that they submit will be of great value once CAIL becomes profitable as anticipated. They point to a pension surplus that at the very least has value by virtue of the contribution holidays that it affords. They also look to the value of the compromised claims of the restructuring itself which they submit are in the order of $449 million. They submit these cumulative benefits add value, currently or at least realizable in the future. In sharp contrast to the Resurgence position that these acts constitute oppressive behaviour, the Minority Shareholders view them as enhancing the value of their shares. They go so far as to suggest that there may well be a current going concern value of the CAC shares that has been conveniently ignored or unquantified and that the Petitioners must put evidence before the court as to what that value is.

166 These arguments overlook several important facts, the most significant being that CAC and CAIL are insolvent and will remain insolvent until the debt restructuring is fully implemented. These companies are not just technically or temporarily insolvent, they are massively insolvent. Air Canada will have invested upward of $3 billion to complete the restructuring, while the Minority Shareholders have contributed nothing. Further, it was a fundamental condition of Air Canada's support of this Plan that it become the sole owner of CAIL. It has been suggested by some that Air Canada's share purchase at two dollars per share in December 1999 was unfairly prejudicial to CAC and CAIL's creditors. Objectively, any expectation by Minority Shareholders that they should be able to participate in a restructured CAIL is not reasonable.

167 The Minority Shareholders asserted the plan is unfair because the effect of the reorganization is to extinguish the common shares of CAIL held by CAC and to convert the voting and non-voting Preferred Shares of CAIL into common shares of CAIL. They submit there is no expert valuation or other evidence to justify the transfer of CAIL's equity to the Preferred Shares. There is no equity in the CAIL shares to transfer. The year end financials show CAIL's shareholder equity at a deficit of $790 million. The Preferred Shares have a liquidation preference of $347 million. There is no evidence to suggest that Air Canada's interim support has rendered either of these companies solvent, it has simply permitted operations to continue. In fact, the unaudited consolidated financial statements of CAC for the quarter ended March 31, 2000 show total shareholders equity went from a deficit of $790 million to a deficit of $1.214 million, an erosion of $424 million.

168 The Minority Shareholders' submission attempts to compare and contrast the rights and expectations of the CAIL preferred shares as against the CAC common shares. This is not a meaningful exercise; the Petitioners are not submitting that the Preferred Shares have value and the evidence demonstrates unequivocally that they do not. The Preferred Shares are merely being utilized as a corporate vehicle to allow CAIL to become a wholly owned subsidiary of Air Canada. For example, the same result could have been achieved by issuing new shares rather than changing the designation of 853350's Preferred Shares in CAIL.

169 The Minority Shareholders have asked the court to sever the reorganization from the debt restructuring, to permit them to participate in whatever future benefit might be derived from the restructured CAIL. However, a fundamental condition of this Plan and the expressed intention of Air Canada on numerous occasions is that CAIL become a wholly owned subsidiary. To suggest the court ought to sever this reorganization from the debt restructuring fails to account for the fact that it is not two plans but an integral part of a single plan. To accede to this request would create an injustice to creditors whose claims are being seriously compromised, and doom the entire Plan to failure. Quite simply, the Plan's funder will not support a severed plan.

170 Finally, the future profits to be derived by Air Canada are not a relevant consideration. While the object of any plan under the CCAA is to create a viable emerging entity, the germane issue is what a prospective purchaser is prepared to pay in the circumstances. Here, we have the one and only offer on the table, Canadian's last and only chance. The evidence demonstrates this offer is preferable to those who have a remaining interest to a liquidation. Where secured creditors have compromised their claims and unsecured creditors are accepting 14 cents on the dollar in a potential pool of unsecured claims totalling possibly in excess of $1 billion, it is not unfair that shareholders receive nothing.

e. The Public Interest

171 In this case, the court cannot limit its assessment of fairness to how the Plan affects the direct participants. The business of the Petitioners as a national and international airline employing over 16,000 people must be taken into account.

172 In his often cited article, *Reorganizations Under the Companies' Creditors Arrangement Act* (1947), 25 Can.Bar R.ev. 587 at 593 Stanley Edwards stated:

> Another reason which is usually operative in favour of reorganization is the interest of the public in the continuation of the enterprise, particularly if the company supplies commodities or services that are necessary or desirable to large numbers of consumers, or if it employs large numbers of workers who would be thrown out of employment by its liquidation. This public interest may be reflected in the decisions of the creditors and shareholders of the company and is undoubtedly a factor which a court would wish to consider in deciding whether to sanction an arrangement under the C.C.A.A.

173 In *Re Repap British Columbia Inc.* (1998), 1 C.B.R. (4th) 49 (B.C. S.C.) the court noted that the fairness of the plan must be measured against the overall economic and business environment and against the interests of the citizens of British Columbia who are affected as "shareholders" of the company, and creditors, of suppliers, employees and competitors of the company. The court approved the plan even though it was unable to conclude that it was necessarily fair and reasonable. In *Re Quintette Coal Ltd.*, *supra*, Thackray J. acknowledged the significance of the coal mine to the British Columbia economy, its importance to the people who lived and worked in the region and to the employees of the company and their families. Other cases in which the court considered the public interest in determining whether to sanction a plan under the CCAA include *Re Canadian Red Cross Society / Société Canadienne de la Croix-Rouge* (1998), 5 C.B.R. (4th) 299 (Ont. Gen. Div. [Commercial List]) and *Algoma Steel Corp. v. Royal Bank* (April 16, 1992), Doc. Toronto B62/91-A (Ont. Gen. Div.)

174 The economic and social impacts of a plan are important and legitimate considerations. Even in insolvency, companies are more than just assets and liabilities. The fate of a company is inextricably tied to those who depend on it

in various ways. It is difficult to imagine a case where the economic and social impacts of a liquidation could be more catastrophic. It would undoubtedly be felt by Canadian air travellers across the country. The effect would not be a mere ripple, but more akin to a tidal wave from coast to coast that would result in chaos to the Canadian transportation system.

175 More than sixteen thousand unionized employees of CAIL and CRAL appeared through counsel. The unions and their membership strongly support the Plan. The unions represented included the Airline Pilots Association International, the International Association of Machinists and Aerospace Workers, Transportation District 104, Canadian Union of Public Employees, and the Canadian Auto Workers Union. They represent pilots, ground workers and cabin personnel. The unions submit that it is essential that the employee protections arising from the current restructuring of Canadian not be jeopardized by a bankruptcy, receivership or other liquidation. Liquidation would be devastating to the employees and also to the local and national economies. The unions emphasize that the Plan safeguards the employment and job dignity protection negotiated by the unions for their members. Further, the court was reminded that the unions and their members have played a key role over the last fifteen years or more in working with Canadian and responsible governments to ensure that Canadian survived and jobs were maintained.

176 The Calgary and Edmonton Airport authorities, which are not for profit corporations, also supported the Plan. CAIL's obligations to the airport authorities are not being compromised under the Plan. However, in a liquidation scenario, the airport authorities submitted that a liquidation would have severe financial consequences to them and have potential for severe disruption in the operation of the airports.

177 The representations of the Government of Canada are also compelling. Approximately one year ago, CAIL approached the Transport Department to inquire as to what solution could be found to salvage their ailing company. The Government saw fit to issue an order in council, pursuant to section 47 of the *Transportation Act*, which allowed an opportunity for CAIL to approach other entities to see if a permanent solution could be found. A standing committee in the House of Commons reviewed a framework for the restructuring of the airline industry, recommendations were made and undertakings were given by Air Canada. The Government was driven by a mandate to protect consumers and promote competition. It submitted that the Plan is a major component of the industry restructuring. Bill C-26, which addresses the restructuring of the industry, has passed through the House of Commons and is presently before the Senate. The Competition Bureau has accepted that Air Canada has the only offer on the table and has worked very closely with the parties to ensure that the interests of consumers, employees, small carriers, and smaller communities will be protected.

178 In summary, in assessing whether a plan is fair and reasonable, courts have emphasized that perfection is not required: see for example *Re Wandlyn Inns Ltd.* (1992), 15 C.B.R. (3d) 316 (N.B. Q.B.), *Quintette Coal*, *supra* and *Repap*, *supra*. Rather, various rights and remedies must be sacrificed to varying degrees to result in a reasonable, viable compromise for all concerned. The court is required to view the "big picture" of the plan and assess its impact as a whole. I return to *Algoma Steel v. Royal Bank*, *supra* at 9 in which Farley J. endorsed this approach:

> What might appear on the surface to be unfair to one party when viewed in relation to all other parties may be considered to be quite appropriate.

179 Fairness and reasonableness are not abstract notions, but must be measured against the available commercial alternatives. The triggering of the statute, namely insolvency, recognizes a fundamental flaw within the company. In these imperfect circumstances there can never be a perfect plan, but rather only one that is supportable. As stated in *Re Sammi Atlas Inc.* (1998), 3 C.B.R. (4th) 171 (Ont. Gen. Div. [Commercial List]) at 173:

> A plan under the CCAA is a compromise; it cannot be expected to be perfect. It should be approved if it is fair, reasonable and equitable. Equitable treatment is not necessarily equal treatment. Equal treatment may be contrary to equitable treatment.

180 I find that in all the circumstances, the Plan is fair and reasonable.

IV. Conclusion

181 The Plan has obtained the support of many affected creditors, including virtually all aircraft financiers, holders of executory contracts, AMR, Loyalty Group and the Senior Secured Noteholders.

182 Use of these proceedings has avoided triggering more than $1.2 billion of incremental claims. These include claims of passengers with pre-paid tickets, employees, landlords and other parties with ongoing executory contracts, trade creditors and suppliers.

183 This Plan represents a solid chance for the continued existence of Canadian. It preserves CAIL as a business entity. It maintains over 16,000 jobs. Suppliers and trade creditors are kept whole. It protects consumers and preserves the integrity of our national transportation system while we move towards a new regulatory framework. The extensive efforts by Canadian and Air Canada, the compromises made by stakeholders both within and without the proceedings and the commitment of the Government of Canada inspire confidence in a positive result.

184 I agree with the opposing parties that the Plan is not perfect, but it is neither illegal nor oppressive. Beyond its fair and reasonable balancing of interests, the Plan is a result of bona fide efforts by all concerned and indeed is the only alternative to bankruptcy as ten years of struggle and creative attempts at restructuring by Canadian clearly demonstrate. This Plan is one step toward a new era of airline profitability that hopefully will protect consumers by promoting affordable and accessible air travel to all Canadians.

185 The Plan deserves the sanction of this court and it is hereby granted. The application pursuant to section 185 of the ABCA is granted. The application for declarations sought by Resurgence are dismissed. The application of the Minority Shareholders is dismissed.

Application granted; counter-applications dismissed.

Footnotes

* Leave to appeal refused 84 Alta. L.R. (3d) 52, 9 B.L.R. (3d) 86, [2000] 10 W.W.R. 314, 2000 ABCA 238, 20 C.B.R. (4th) 46 (Alta. C.A. [In Chambers]).

2000 ABCA 238
Alberta Court of Appeal [In Chambers]

Canadian Airlines Corp., Re

2000 CarswellAlta 919, 2000 ABCA 238, [2000] 10 W.W.R. 314, [2000] A.W.L.D. 655, [2000] A.J. No. 1028, 20 C.B.R. (4th) 46, 228 W.A.C. 131, 266 A.R. 131, 84 Alta. L.R. (3d) 52, 99 A.C.W.S. (3d) 533, 9 B.L.R. (3d) 86

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

And In the Matter of the Business Corporations Act (Alberta) S.A. 1981, c. B-15, as amended, Section 185;

And In the Matter of Canadian Airlines Corporation and Canadian Airlines International Ltd.; Resurgence Asset Management LLC (Applicant) and Canadian Airlines Corporation and Canadian Airlines International Ltd. (Respondents)

Wittmann J.A.

Heard: August 3, 2000
Judgment: August 29, 2000
Docket: Calgary Appeal 00-08901

Proceedings: refused leave to appeal *Canadian Airlines Corp., Re* (2000), 2000 CarswellAlta 662, 2000 ABQB 442, [2000] 10 W.W.R. 269, 20 C.B.R. (4th) 1, 84 Alta. L.R. (3d) 9, 9 B.L.R. (3d) 41, 265 A.R. 201 (Alta. Q.B.); affirmed (2000), 2000 CarswellAlta 1556, 2001 ABCA 9, [2001] 3 W.W.R. 1 (Alta. C.A.)

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H.M. Kay, *Q.C.*, *A.L. Friend*, *Q.C.*, and *L.A. Goldbach*, for Respondents.
S.F. Dunphy, for Air Canada.
F.R. Foran, *Q.C.*, for Monitor, Pricewaterhouse Coopers.

Subject: Corporate and Commercial; Civil Practice and Procedure; Insolvency

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Galcor Hotel Managers Ltd. v. Imperial Financial Services Ltd. (1993), 81 B.C.L.R. (2d) 142, 31 B.C.A.C. 161, 50 W.A.C. 161 (B.C. C.A.) — considered

Gibbex Mines Ltd. v. International Video Cassettes Ltd., [1975] 2 W.W.R. 10, 49 D.L.R. (3d) 731 (B.C. S.C.) — considered

Harris v. Universal Explorations Ltd. (1982), 16 B.L.R. 186, (sub nom. *Universal Explorations Ltd., Re)* 18 Alta. L.R. (2d) 119, 35 A.R. 71 (Alta. T.D.) — considered

Norcan Oils Ltd. v. Fogler (1964), [1965] S.C.R. 36, 49 W.W.R. 321, 46 D.L.R. (2d) 630 (S.C.C.) — considered

Schmidt v. Air Products of Canada Ltd., 3 C.C.P.B. 1, 20 Alta. L.R. (3d) 225, (sub nom. *Stearns Catalytic Pension Plans, Re)* 168 N.R. 81, [1994] 8 W.W.R. 305, 3 E.T.R. (2d) 1, 4 C.C.E.L. (2d) 1, [1994] 2 S.C.R. 611, 115 D.L.R. (4th) 631, (sub nom. *Stearns Catalytic Pension Plans, Re)* 155 A.R. 81, (sub nom. *Stearns Catalytic Pension Plans, Re)* 73 W.A.C. 81, C.E.B. & P.G.R. 8173 (S.C.C.) — referred to

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Statutes considered:

Business Corporations Act, S.A. 1981, c. B-15

s. 185 — considered

s. 234 — considered

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

s. 4 — considered

s. 5 — considered

s. 6 — considered

s. 13 — considered

APPLICATION by investment corporation for leave to appeal from judgment reported at 84 Alta. L.R. (3d) 9, 9 B.L.R. (3d) 41, [2000] 10 W.W.R. 269, 2000 ABQB 442, 20 C.B.R. (4th) 1 (Alta. Q.B.), approving airline's plan of arrangement under *Companies' Creditors Arrangement Act.*

***Wittmann J.A.* [In Chambers]:**

INTRODUCTION

1 This is an application by Resurgence Asset Management LLC ("Resurgence") for leave to appeal the order of Paperny, J., dated June 27, 2000, [reported 84 Alta. L.R. (3d) 9, [2000] 10 W.W.R. 269 (Alta. Q.B.)] pursuant to proceedings under the *Companies' Creditors Arrangement Act*, R.S.C. 1985, c. C-36, as amended, ("*CCAA*"). The order sanctioned a plan of compromise and arrangement ("the Plan") proposed by Canadian Airlines Corporation ("CAC") and Canadian Airlines International Ltd. ("CAIL") (together, "Canadian") and dismissed an application by Resurgence for a declaration that Resurgence was an unaffected creditor under the Plan.

BACKGROUND

2 Resurgence was the holder of 58.2 per cent of $100,000,000.00 (U.S.) of the unsecured notes issued by CAC.

3 CAC was a publicly traded Alberta corporation which, prior to the June 27 order of Paperny, J., owned 100 per cent of the common shares of CAIL, the operating company of Canadian Airlines.

4 Air Canada is a publicly traded Canadian corporation. Air Canada owned 10 per cent of the shares of 853350 Alberta Ltd. ("853350"), which prior to the June 27 order of Paperny, J., owned all the preferred shares of CAIL.

5 As described in detail by the learned chambers judge in her reasons, Canadian had been searching for a decade for a solution to its ongoing, significant financial difficulties. By December 1999, it was on the brink of bankruptcy. In a series of transactions including 853350's acquisition of the preferred shares of CAIL, Air Canada infused capital into Canadian and assisted in debt restructuring.

6 Canadian came to the conclusion that it must conclude its debt restructuring to permit the completion of a full merger between Canadian and Air Canada. On February 1, 2000, to secure liquidity to continue operating until debt restructuring was achieved, Canadian announced a moratorium on payments to lessors and lenders. CAIL, Air Canada and lessors of 59 aircraft reached an agreement in principle on a restructuring plan. They also reached agreement with other secured creditors and several major unsecured creditors with respect to restructuring.

7 Canadian still faced threats of proceedings by secured creditors. It commenced proceedings under the *CCAA* on March 24, 2000. Pricewaterhouse Coopers Inc. was appointed as Monitor by court order.

8 Arrangements with various aircraft lessors, lenders and conditional vendors which would benefit Canadian by reducing rates and other terms were approved by court orders dated April 14, 2000 and May 10, 2000.

9 On April 25, 2000, in accordance with the March 24 court order, Canadian filed the Plan which was described as having three principal objectives:

(a) To provide near term liquidity so that Canadian can sustain operations;

(b) To allow for the return of aircraft not required by Canadian; and

(c) To permanently adjust Canadian's debt structure and lease facilities to reflect the current market for asset value and carrying costs in return for Air Canada providing a guarantee of the restructured obligations.

10 The Plan generally provided for stakeholders by category as follows:

(a) Affected unsecured creditors, which included unsecured noteholders, aircraft claimants, executory contract claimants, tax claimants and various litigation claimants, would receive 12 cents per dollar (later changed to 14 cents per dollar) of approved claims;

(b) Affected secured creditors, the senior secured noteholders, would receive 97 per cent of the principal amount of their claim plus interest and costs in respect of their secured claim, and a deficiency claim as unsecured creditors for the remainder;

(c) Unaffected unsecured creditors, which included Canadian's employees, customers and suppliers of goods and services, would be unaffected by the Plan;

(d) Unaffected secured creditor, the Royal Bank, CAIL's operating lender, would not be affected by the Plan.

11 The Plan also proposed share capital reorganization by having all CAIL common shares held by CAC converted into a single retractable share, which would then be retracted by CAIL for $1.00, and all CAIL preferred shares held by 853350 converted into CAIL common shares. The Plan provided for amendments to CAIL's articles of incorporation to effect the proposed reorganization.

12 On May 26, 2000, in accordance with the orders and directions of the court, two classes of creditors, the senior secured noteholders and the affected unsecured creditors voted on the Plan as amended. Both classes approved the Plan by the majorities required by ss. 4 and 5 of the *CCAA*.

13 On May 29, 2000, by notice of motion, Canadian sought court sanction of the Plan under s. 6 of the *CCAA* and an order for reorganization pursuant to s. 185 of the *Business Corporations Act* (Alberta), S.A. 1981, c. B-15 as amended ("*ABCA*"). Resurgence was among those who opposed the Plan. Its application, along with that of four shareholders of CAC, was ordered to be tried during a hearing to consider the fairness and reasonableness of the Plan ("the fairness hearing").

14 Resurgence sought declarations that the actions of Canadian, Air Canada and 853350 constitute an amalgamation, consolidation or merger with or into Air Canada or a conveyance or transfer of all or substantially all of Canadian's assets to Air Canada; that any plan of arrangement involving Canadian will not affect Resurgence and directing the repurchase of their notes pursuant to provisions of their trust indenture and that the actions of Canadian, Air Canada and 853350 were oppressive and unfairly prejudicial to it pursuant to s. 234 of the *ABCA*.

15 The fairness hearing lasted two weeks during which *viva voce* evidence of six witnesses was heard, including testimony of the chief financial officers of Canadian and Air Canada. Submissions by counsel were made on behalf of the federal government, the Calgary and Edmonton airport authorities, unions representing employees of Canadian and various creditors of Canadian. The court also received two special reports from the Monitor.

16 As part of assessing the fairness of the Plan, the learned chambers judge received a liquidation analysis of CAIL, prepared by the Monitor, in order to estimate the amounts that might be recovered by CAIL's creditors and shareholders in the event that CAIL's assets were disposed of by a receiver or trustee. The Monitor concluded that liquidation would result in a shortfall to certain secured creditors, that recovery by unsecured creditors would be between one and three cents on the dollar, and that there would be no recovery by shareholders.

17 The learned chambers judge stated that she agreed with the parties opposing the Plan that it was not perfect, but it was neither illegal, nor oppressive, and therefore, dismissed the requested declarations and relief sought by Resurgence. Further, she held that the Plan was the only alternative to bankruptcy as ten years of struggle and failed creative attempts at restructuring clearly demonstrated. She ruled that the Plan was fair and reasonable and deserving of the sanction of the court. She granted the order sanctioning the Plan, and the application pursuant to s. 185 of the *ABCA* to reorganize the corporation.

LEAVE TO APPEAL UNDER THE *CCAA*

18 The *CCAA* provides for appeals to this Court as follows:

> 13. Except in the Yukon Territory, any person dissatisfied with an order or a decision made under this Act may appeal therefrom on obtaining leave of the judge appealed from or of the court or a judge or the court to which the appeal lies and on such terms as to security and in other respects as the judge or court directs.

19 As set out in *Re Canadian Airlines Corp.*, 2000 ABCA 149 (Alta. C.A. [In Chambers]) ("*Resurgence No. 1*"), a decision on a leave application sought earlier in this action, and as conceded by all the parties to this application, the criterion to be applied in an application for leave to appeal is that there must be serious and arguable grounds that are of real and significant interest to the parties. This criterion subsumes four factors to be considered by the court:

(1) whether the point on appeal is of significance to the practice;

(2) whether the point raised is of significance to the action itself;

(3) whether the appeal is *prima facie* meritorious or, on the other hand, whether it is frivolous; and

(4) whether the appeal will unduly hinder the progress of the action.

20 The respondents argue that apart from the test for leave, mootness is an additional overriding factor in the present case which is dispositive against the granting of leave to appeal.

MOOTNESS

21 In *Galcor Hotel Managers Ltd. v. Imperial Financial Services Ltd.* (1993), 81 B.C.L.R. (2d) 142 (B.C. C.A.), an order authorizing the distribution of substantially all the assets of a limited partnership had been fully performed. The appellants appealed, seeking to have the order vacated. The appellants had unsuccessfully applied for a stay of the order. In deciding whether to allow the appeal to be presented, Gibbs, J.A., for the court, said there was no merit, substance or prospective benefit that could accrue to the appellants, and that the appeal was therefore moot.

22 In *Borowski v. Canada (Attorney General)*, [1989] 1 S.C.R. 342 (S.C.C.), Sopinka, J. for the court, held that where there is no longer a live controversy or concrete dispute, an appeal is moot.

23 No stay of the June 27 order was obtained or even sought. In reliance on that order, most of the transactions contemplated by the Plan have been completed. According to the Affidavit of Paul Brotto, sworn July 6, 2000, filed July 7, 2000, the following occurred:

> 5. The transactions contemplated by the Plan have been completed in reliance upon the Sanction Order. The completion of the transactions has involved, among other things, the following steps:
>
> > (a) Effective July 4, 2000, all of the depreciable property of CAIL was transferred to a wholly-owned subsidiary of CAIL and leased back from such subsidiary by CAIL;
> >
> > (b) Articles of Reorganization of CAIL, being Schedule "D" to the Plan (which is Exhibit "A" to the Sanction Order), were filed and a Certificate of Amendment and Registration of Restated Articles was issued by the Registrar of Corporations pursuant to the Sanction Order, and in accordance with sections 185 and 255 of the Business Corporations Act (Alberta) (the "Certificate") on July 5, 2000. Pursuant to the Articles of Reorganization, the common shares of CAIL formerly held by CAC were converted to retractable preferred shares and the same were retracted. All preferred shares of CAIL held by 853350 Alberta Ltd. ("853350") were converted into CAIL common shares;
> >
> > (c) The "Section 80.04 Agreement" referred to in the Plan between CAIL and CAC, pursuant to which certain forgiveness of debt obligations under s.80 of the Income Tax Act were transferred from CAIL to CAC, has been entered into as of July 5, 2000;
> >
> > (d) Payment of $185,973,411 (US funds) has been made to the Trustee on behalf of all holders of Senior Secured Notes as provided for in the Plan and 853350 has acquired the Amended Secured Intercompany Note; and
> >
> > (e) Payments have been made to Affected Unsecured Creditors holding Unsecured Proven Claims and further payments will be made upon the resolution of disputed claims by the Claims officer; and
> >
> > (f) It is expected that payment will be made within several days of the date of this Affidavit to the Trustee, on behalf of the Unsecured Notes, in the amount 14 percent of approximately $160,000,000.

24 In *Norcan Oils Ltd. v. Fogler* (1964), [1965] S.C.R. 36 (S.C.C.), it was held that the Alberta Supreme Court Appellate Division could not set aside or revoke a certificate of amalgamation after the registrar of companies had issued the certificate in accordance with a valid court order and the corporations legislation. A notice appealing the order had been served but no stay had been obtained. Absent express legislative authority to reverse the process once the certificate had

been issued, the majority of the Supreme Court of Canada held the amalgamation could not be unwound and therefore, an appellate court ought not to make an order which could have no effect.

25 Courts following *Norcan Oils Ltd.* have recognized that any right to appeal will be lost if a party does not obtain a stay of the filing of an amalgamation approval order: *Harris v. Universal Explorations Ltd.* (1982), 35 A.R. 71 (Alta. T.D.) and *Gibbex Mines Ltd. v. International Video Cassettes Ltd.*, [1975] 2 W.W.R. 10 (B.C. S.C.).

26 *Norcan* applies to bind this Court in the present action where CAIL's articles of reorganization were filed with the Registrar of Corporations on July 5, 2000 and pursuant to the provisions of the *ABCA*, a certificate amending the articles was issued. The certificate cannot now be rescinded. There is no provision in the ***ABCA*** for reversing a reorganization.

27 The respondents point out that there are other irreversible changes which have occurred since the date of the June 27, 2000 order. They include changes in share structure, changes in management personnel, implementation of a restructuring plan that included a repayment agreement with its principal lender and other creditors and payments to third parties. [Affidavit of Paul Brotto, paras. 6, 7, 8, 9, 10, 11, 12.]

28 The applicant relies on *Re Blue Range Resource Corp.* (1999), 244 A.R. 103 (Alta. C.A.), to argue that leave to appeal can be granted after a *CCAA* plan has been implemented. In that case, as noted by Fruman, J.A. at 106, a plan was in place and an appeal of the issues which were before her would not unduly hinder the progress of restructuring.

29 In this case, however, the proposed appeal by Resurgence would interfere with the restructuring since the remedies it seeks requires that the Plan be set aside. One proposed ground of appeal attacks the fairness and reasonableness of the Plan itself when the Plan has been almost fully implemented. It cannot be said that the proposed appeal would not unduly hinder the progress of restructuring.

30 If the proposed appeal were allowed, this Court cannot rewrite the Plan; nor could it remit the matter back to the *CCAA* supervising judge for such purpose. It must either uphold or set aside the approval of the Plan granted by the court below. In effect, if Resurgence succeeded on appeal, the Plan would be vacated. However, that remedy is no longer possible, at minimum, because the certificate issued by the Registrar cannot be revoked. As stated in *Norcan Oils Ltd.*, an appellate court cannot order a remedy which could have no effect. This Court cannot order that the Plan be undone in its entirety.

31 Similarly, the other ground of Resurgence's proposed appeal, oppression under s. 234 of the *ABCA*, cannot be allowed since that remedy must be granted within the context of the *CCAA* proceedings. As recognized by the learned chambers judge, allegations of oppression were considered in the test for fairness when seeking judicial sanction of the Plan. As she discussed at paragraphs 140-145 of her reasons, the starting point in any determination of oppression under the *ABCA* requires an understanding of the rights, interests and reasonable expectations which must be objectively assessed. In this action, the rights, interests and reasonable expectations of both shareholders and creditors must be considered through the lens of *CCAA* insolvency legislation. The complaints of Resurgence, that its rights under its trust indenture have been ignored or eliminated, are to be seen as the function of the insolvency, and not of oppressive conduct. As a consequence, even if Resurgence were to successfully appeal on the ground of oppression, the remedy would not be to give effect to the terms of the trust indenture. This Court could only hold that the fairness test for the court's sanction was not met and therefore, the approval of the Plan should be set aside. Again, as explained above, reversing the Plan is no longer possible.

32 The applicant was unable to point to any issue where this Court could grant a remedy and yet leave the Plan unaffected. It proposed on appeal to seek a declaration that it be declared an unaffected unsecured creditor. That is not a ground of appeal but is rather a remedy. As the respondents argued, the designation of Resurgence as an affected unsecured creditor was part of the Plan. To declare it an unaffected unsecured creditor requires vacating the Plan. On every ground proposed by the applicant, it appears that the response of this Court can only be to either uphold or set aside the approval of the court below. Setting aside the approval is no longer possible since essential elements of the

Plan have been implemented and are now irreversible. Thus, the applicant cannot be granted the remedy it seeks. No prospective benefit can accrue to the applicant even if it succeeded on appeal. The appeal, therefore, is moot.

DISCRETION TO HEAR MOOT APPEALS

33 Even if an appeal could provide no benefit to the applicants, should leave be granted?

34 In *Borowski*, *supra*, Sopinka, J. described the doctrine of mootness at 353. He said that, as an aspect of a general policy or practice, a court may decline to decide a case which raises merely a hypothetical or abstract questions and will apply the doctrine when the decision of the court will have no practical effect of resolving some controversy affecting the rights of parties.

35 After discussing the principles involved in deciding whether an issue was moot, Sopinka, J. continued at 358 to describe the second stage of the analysis by examining the basis upon which a court should exercise its discretion either to hear or decline to hear a moot appeal. He examined three underlying factors in the rationale for the exercise of discretion in departing from the usual practice. The first is the requirement of an adversarial context which helps guarantee that issues are well and fully argued when resolving legal disputes. He suggested the presence of collateral consequences may provide the necessary adversarial context. Second is the concern for judicial economy which requires that special circumstances exist in a case to make it worthwhile to apply scare judicial resources to resolve it. Third is the need for the court to demonstrate a measure of awareness of its proper law-making function as the adjudicative branch in the political framework. Judgments in the absence of a dispute may be viewed as intruding into the role of the legislative branch. He concluded at 363:

> In exercising its discretion in an appeal which is moot, the court should consider the extent to which each of the three basic rationalia for enforcement of the mootness doctrine is present. This is not to suggest that it is a mechanical process. The principles identified above may not all support the same conclusion. The presence of one or two of the factors may be overborne by the absence of the third and vice versa.

36 The third factor underlying the rationale does not apply in this case. As for the first criterion, the circumstances of this case do not reveal any collateral consequences, although, it may be assumed that the necessary adversarial context could be present. However, there are no special circumstances making it worthwhile for this Court to ration scarce judicial resources to the resolution of this dispute. This outweighs the other two factors in concluding that the mootness doctrine should be enforced.

37 On the ground of mootness, leave to appeal should not be granted.

38 I am supported in this conclusion by similar cases before the British Columbia Court of Appeal, *Sparling v. Northwest Digital Ltd.* (1991), 47 C.P.C. (2d) 124 (B.C. C.A.) and *Galcor*, *supra*.

39 In *Sparling*, a company sought to restructure its financial basis and called a special meeting of shareholders. A court order permitted the voting of certain shares at the shareholders' meeting. A director sought to appeal that order. On the basis of the initial order, the meeting was held, the shares were voted and some significant changes to the company occurred as a result. Hollinrake, J.A. for the court described these as substantial changes which are irreversible. He found that the appeal was moot because there was no longer a live controversy. After considering *Borowski*, he also concluded that the court should not exercise its discretion to depart from the usual practice of declining to hear moot appeals.

40 In *Galcor*, as stated earlier, an order authorizing the distribution of certain monies to limited partners was appealed. A stay was sought but the application was dismissed. An injunction to restrain the distribution of monies was also sought and refused. The monies were distributed. The B.C. Court of Appeal held there was no merit, no substance and no prospective benefit to the appellants nor could they find any merit in the argument that there would be a collateral advantage if the appeal were heard and allowed. None of the criteria in *Borowski* were of assistance as there was no issue

of public importance and no precedent value to other cases. Gibbs, J.A. was of the opinion it would not be prudent to use judicial time to hear a moot case as the rationing of scarce judicial resources was of importance and concern to the court.

APPLICATION OF THE CRITERIA FOR LEAVE

41 In any event, consideration of the usual factors in granting leave to appeal does not result in the granting of leave.

42 In particular, the applicant has not established *prima facie* meritorious grounds. The issue in the proposed appeal must be whether the learned chambers judge erred in determining that the Plan was fair and reasonable. As discussed in *Resurgence No. 1*, regard must be given to the standard of review this Court would apply on appeal when considering a leave application. The applicant has been unable to point to an error on a question of law, or an overriding and palpable error in the findings of fact, or an error in the learned chambers judge's exercise of discretion.

43 Resurgence submits that serious and arguable grounds surround the following issues: (a) Should Resurgence be treated as an unaffected creditor under the Plan? and (b) Should the Plan have been sanctioned under s. 6 of the *CCAA*? The applicant cannot show that either issue is based on an appealable error.

44 On the second issue, the main argument of the applicant is that the learned chambers judge failed to appreciate that the vote in favour of the Plan was not fair. At bottom, most of the submissions Resurgence made on this issue are directed at the learned chambers judge's conclusion that shareholders and creditors of Canadian would not be better off in bankruptcy than under the Plan. To appeal this conclusion, based on the findings of fact and exercise of discretion, Resurgence must establish that it has a *prima facie* meritorious argument that the learned chambers judge's error was overriding and palpable, or created an unreasonable result. This, it has not done.

45 Resurgence also argues that the acceptance of the valuations given by the Monitor to certain assets, in particular, Canadian Regional Airlines Limited ("CRAL"), the pension surplus and the international routes was in error. The Monitor did not attribute value to these assets when it prepared the liquidation analysis. Resurgence argued that the learned chambers judge erred when she held that the Monitor was justified in making these omissions.

46 Resurgence argued that CRAL was worth as much as $260 million to Air Canada. The Monitor valued CRAL on a distressed sale basis. It assumed that without CAIL's national and international network to feed traffic and considering the negative publicity which the failure of CAIL would cause, CRAL would immediately stop operations.

47 The learned chambers judge found that there was no evidence of a potential purchaser for CRAL. She held that CRAL had a value to CAIL and could provide value of Air Canada, but this was attributable to CRAL's ability to feed traffic to and take traffic from the national and international service of CAIL. She held that the Monitor properly considered these factors. The $260 million dollar value was based on CRAL as a going concern which was a completely different scenario than a liquidation analysis. She accepted the liquidation analysis on the basis that if CAIL were to cease operations, CRAL would be obliged to do so as well and that would leave no going concern for Air Canada to acquire.

48 CRAL may have some value, but even assuming that, Resurgence has not shown that it has a *prima facie* meritorious argument that the learned chambers judge committed an overriding and palpable error in finding that the Monitor was justified in concluding CRAL would not have any value assuming a windup of CAIL. She found that there was no evidence of a market for CRAL as a going concern. Her preference for the liquidation analysis was a proper exercise of her discretion and cannot be said to have been unreasonable.

49 Resurgence also argued that the pension plan surplus must be given value and included in the liquidation analysis because the surplus may revert to the company depending upon the terms of the plan. There was some evidence that in the two pension plans, with assets over $2 billion, there may be a surplus of $40 million. The Monitor attributed no value because of concerns about contingent liabilities which made the true amount of any available surplus indefinite and also because of the uncertainty of the entitlement of Canadian to any such amount.

50 The learned chambers judge found that no basis had been established for any surplus being available to be withdrawn from an ongoing pension plan. She also found that the evidence showed the potential for significant contingencies. Upon termination of the plan, further reductions for contingent benefits payable in accordance with the plans, any wind up costs, contribution holidays and litigation costs would affect a determination of whether there was a true surplus. The evidence before the learned chambers judge included that of the unionized employees who expected to dispute all the calculations of the pension plan surplus and the entitlement to the surplus. The learned chambers judge observed also that the surplus could quickly disappear with relatively minor changes in the market value of the securities held or in the calculation of liabilities. She concluded that given all variables, the existence of any surplus was doubtful at best and held that ascribing a zero value was reasonable in the circumstances.

51 In addition to the evidence upon which the learned chambers judge based her conclusion, she is also supported by the case law which demonstrates that even if a pension surplus existed and was accessible, entitlement is a complex question: *Schmidt v. Air Products of Canada Ltd.*, [1994] 2 S.C.R. 611 (S.C.C.).

52 Resurgence argued that the international routes of Canadian should have been treated as valuable assets. The Monitor took the position that the international routes were unassignable licences in control of the Government of Canada and not property rights to be treated as assets by the airlines. Resurgence argues that the Monitor's conclusion was wrong because there was evidence that the international routes had value. In December 1999, CAIL sold its Toronto - Tokyo route to Air Canada for $25 million. Resurgence also pointed to statements made by Canadian's former president and CEO in mid-1999 that the value of its international routes was $2 billion. It further noted that in the United States, where the government similarly grants licences to airlines for international routes, many are bought and sold.

53 The learned chambers judge found the evidence indicated that the $25 million paid for the Toronto-Tokyo route was not an amount derived from a valuation but was the amount CAIL needed for its cash flow requirements at the time of the transaction in order to survive. She found that the statements that CAIL's international routes were worth $2 billion reflected the amount CAIL needed to sustain liquidity without its international routes and was not the market value of what could realistically be obtained from an arm's length purchaser. She found there was no evidence of the existence of an arm's length purchaser. As the respondents pointed out, the Canadian market cannot be compared to the United States. Here in Canada, there is no other airline which would purchase international routes, except Air Canada. Air Canada argued that it is pure speculation to suggest it would have paid for the routes when it could have obtained the routes in any event if Canadian went into liquidation.

54 Even accepting Resurgence's argument that those assets should have been given some value, the applicant has not established a *prima facie* meritorious argument that the learned chambers judge was unreasonable to have accepted the valuations based on a liquidation analysis rather than a market value or going concern analysis nor that she lacked any evidence upon which to base her conclusions. She found that the evidence was overwhelming that all other options had been exhausted and have resulted in failure. As described above, she had evidence upon which to accept the Monitor's valuations of the disputed assets. It is not the role of this Court to review the evidence and substitute its opinion for that of the learned chambers judge. She properly exercised her discretion and she had evidence upon which to support her conclusions. The applicant, therefore, has not established that its appeal is *prima facie* meritorious.

55 On the first issue, Resurgence argues that it should be an unaffected creditor to pursue its oppression remedy. As discussed above, the oppression remedy cannot be considered outside the context of the *CCAA* proceedings. The learned chambers judge concluded that the complaints of Resurgence were the result of the insolvency of Canadian and not from any oppressive conduct. The applicant has not established any *prima facie* error committed by the learned chambers judge in reaching that conclusion.

56 Thus, were this appeal not moot, leave would not be granted as the applicant has not met the threshold for leave to appeal.

CONCLUSION

57 The application for leave to appeal is dismissed because it is moot, and in any event, no serious and arguable grounds have been established upon which to found the basis for granting leave.

Application dismissed.

32

1995 CarswellOnt 1167
Ontario Court of Appeal

Barnabe v. Touhey

1995 CarswellOnt 1167, [1995] O.J. No. 3456, 10 E.T.R. (2d) 68, 26 O.R. (3d) 477, 37 C.B.R. (3d) 73, 59 A.C.W.S. (3d) 151

JEFFREY C. BARNABE, TERRILL C. JAMESON, TIMOTHY D. RAY, WILLIAM J.S. DEVONISH and DEREK G. NICHOLSON (applicants/respondents in appeal) v. JAMES W. TOUHEY and JOHN R. SIGOUIN (respondents/respondents in appeal)

JAMES W. TOUHEY and JOHN R. SIGOUIN (plaintiffs/respondents in appeal) v. JEFFREY C. BARNABE, TERRILL C. JAMESON, TIMOTHY D. RAY, WILLIAM J.S. DEVONISH and DEREK G. NICHOLSON (defendants/respondents in appeal); CANADIAN IMPERIAL BANK OF COMMERCE (intervenor/appellant)

McKinlay, Catzman and Abella JJ.A.

Heard: November 8-9, 1995
Judgment: November 14, 1995
Docket: Doc. CA C18932

Counsel: *Sean E. Cumming* and *Percy Ostroff* , for appellant, Canadian Imperial Bank of Commerce.
James M. O'Grady, Q.C. , and *Barry Kwasniewski* , for respondent Jeffrey Barnabe.
John A. Hollander , for respondent John R. Sigouin.

Subject: Restitution; Estates and Trusts; Corporate and Commercial; Insolvency

Headnote

Restitution --- Benefits arising through wrongful acts — Money or goods inequitably retained

Trusts and Trustees --- Constructive trust

Trusts and Trustees --- Constructive trust — Gains by fiduciaries

Property of bankrupt — Trust property — Constructive trust — Constructive trust may have effect of granting payment to beneficiary out of fund that would otherwise be part of bankrupt's estate — Imposition of trust cannot have that result as its purpose.

The remedy of constructive trust will be imposed where there is some unjust enrichment. Such a trust must be imposed over specific property in which the person claiming the trust has reasonable expectation of obtaining an interest. While a constructive trust, properly imposed, could have the *effect* of granting to the beneficiary of the trust payment out of funds that would otherwise become part of the bankrupt's estate divisible among his or her creditors, a constructive trust cannot be imposed for that *purpose* . To impose a trust for that purpose would amount to creating what may be a fair result between the constructive trustee and the beneficiary to the detriment of all other creditors of the bankrupt.

Appeal from judgment reported at (1994), 4 E.T.R. (2d) 22, 18 O.R. (3d) 370 (Gen. Div.) granting declaration of constructive trust.

***Per curiam*:**

1 We agree with counsel for the appellant that the order of Bell J. requiring that property of the bankrupts Touhey and Sigouin be held on a constructive trust in favour of the respondents has the effect of granting to the respondents a floating charge over all of the assets of the bankrupts in priority to the other creditors of the bankrupts.

2 We are of the opinion that the remedy of constructive trust is not appropriate in the circumstances. To dispose of this appeal, it is not necessary to refer to all of the arguments dealt with by counsel, since we are of the view that the unjust enrichment on which the constructive trust remedy is based does not exist in this case. To establish the unjust enrichment, there must be some specific property which is the subject of the enrichment, that property must have been retained by the person holding it in deprivation of the party claiming the trust, and there must be no juristic reason for the retention.

3 As to the first requirement, in this case there is no specific property which is the subject of the trust. The property ordered held comprises all of the property of the bankrupts. This alone would probably be sufficient to decide the appeal. However, we will comment on the other requirements to establish an unjust enrichment.

4 As to the second requirement, that the property must be held in deprivation of the party claiming the unjust enrichment, it is clear that the parties which are said to hold the trust property, the Canadian Imperial Bank of Commerce ("the bank") or Messrs. Touhey and Sigouin, do not hold it in deprivation of the respondents. The property said to be the subject of the trust is money which, by the order of Farley J., dated May 17, 1990, should have been paid back to the accountant administering the assets of the original "1986" partnership. The motions judge found that these monies, which were not paid back as they should have been, were deposited in the bank and used to support the operations of the new "1990" partnership. There is no evidence which clearly establishes that this money was ever paid into the account of the new partnership at the bank. However, even if it was, there is no evidence that indicates that the funds remain in the hands of the bank. Indeed, the account involved has generally been in negative balance, and, since it was an operating account of the new partnership, funds were paid in and out of the account over a period in excess of four years before the motions judge made the order imposing a constructive trust. Under those circumstances, it is almost impossible to show any true connection between funds which may have been deposited in the "1990" partnership account and the assets of that partnership or of the bankrupts. To overcome this problem, the motions judge imposed a constructive trust over all of the assets of the bankrupts. This is contrary to clear law which requires that a constructive trust be imposed over specific property in which the person claiming the trust has a reasonable expectation of obtaining a property interest. While the respondents may not have succeeded in having funds returned to the accountant by Touhey and Sigouin, as required by the order of Farley J., they were not deprived of any of the assets which were made the subject of the constructive trust. They were merely unsecured creditors of Touhey and Sigouin.

As to the third requirement, that there be no juristic reason for the retention of the property, there are at least two juristic reasons why the bank should retain the funds involved (if they were in fact deposited in the "1990" partnership account). First, the bank, through the account of the "1990" partnership, financed at least some of the operations of that partnership. In order to do so, it obtained security over the receivables and other assets of the partnership, which are subject to the order of Bell J. It was in reliance on that security that the bank financed the operations of the "1990" partnership. It was entitled to retain any funds which may have been paid into the account to reimburse it for payments out of the account, and it was entitled to its security for the purpose of securing payment. The second juristic reason for retention of the funds is that the order of Farley J., by its terms, anticipated that the funds paid over by the accountant administering the assets of the "1986" partnership would be returned only if needed and demanded. Funds were also paid over to the other partners in the "1986" partnership, and none were required by the order to hold any funds in trust; indeed, any such order would have rendered the original payment over of no practical benefit to any of the partners.

While a constructive trust, if appropriately established, could have the *effect* of the beneficiary of the trust receiving payment out of funds which would otherwise become part of the estate of a bankrupt divisible among his creditors, a constructive trust, otherwise unavailable, cannot be imposed for that *purpose* . This would amount to imposing what may be a fair result as between the constructive trustee and beneficiary, to the unfair detriment of all other creditors of the bankrupt.

The appeal is allowed with costs, and the judgment of Bell J. is set aside to be replaced by a judgment dismissing the application with costs.

Appeal allowed.

33

1997 CarswellOnt 1489
Supreme Court of Canada

Soulos v. Korkontzilas

1997 CarswellOnt 1489, 1997 CarswellOnt 1490, [1997] 2 S.C.R. 217, [1997] S.C.J. No. 52, 100 O.A.C. 241, 146 D.L.R. (4th) 214, 17 E.T.R. (2d) 89, 212 N.R. 1, 32 O.R. (3d) 716 (headnote only), 32 O.R. (3d) 716 (note), 32 O.R. (3d) 716, 46 C.B.R. (3d) 1, 71 A.C.W.S. (3d) 194, 9 R.P.R. (3d) 1, J.E. 97-1111

Fotios Korkontzilas, Panagiota Korkontzilas and Olympia Town Real Estate Limited, Appellants v. Nick Soulos, Respondent

La Forest, Sopinka, Gonthier, Cory, McLachlin, Iacobucci and Major JJ.

Heard: February 8, 1997
Judgment: May 22, 1997
Docket: 24949

Proceedings: affirming (1995), 84 O.A.C 390 (Ont. C.A..); reversing (1991), 4 O.R. (3d) 51 (Ont. Gen. Div.); additional reasons at (1991), 4 O.R. (3d) 51 at 71 (Ont. Gen. Div.)

Counsel: *Thomas G. Heintzman, Q.C.* , and *Darryl A. Cruz* , for the appellants.
David T. Stockwood, Q.C. , and *Susan E. Caskey* , for the respondent.

Subject: Torts; Contracts; Estates and Trusts; Insolvency; Property

Headnote

Trusts and Trustees --- Constructive trust — Gains by fiduciaries

Appeal dismissed.

Agency --- Relationship between principal and agent — Agent's duties to principal — Fiduciary duty — Duty to disclose

Appeal dismissed.

Fiducies et fiduciaires --- Fiducie par interprétation — Avantages tirés par le fiduciaire

Pourvoi a été rejeté.

Mandat --- Relation entre le mandant et le mandataire — Obligations du mandataire envers le mandant — Obligation fiduciaire — Obligation d'informer — Courtier en immeuble n'a pas informé son client que le vendeur avait accepté son offre pour une propriété

Pourvoi a été rejeté.

A real estate broker failed to advise his client that the seller of a commercial property had accepted the client's counter-offer and arranged for his wife to purchase the property. Title was then transferred to the broker and his wife as joint tenants. When the client discovered what had happened, he commenced an action against the broker for breach of fiduciary duty and sought to have the property conveyed to him on the basis of constructive trust. The client had not suffered any monetary loss as a result of the broker's conduct because of a subsequent decrease in the market value of the property. However, the client still wanted the property because of the prestige associated with the ownership of it.

At trial, the broker was found to have been in breach of fiduciary duty, but the judge refused to grant the constructive trust remedy because the broker had not been enriched by his purchase of the property, in that its value had decreased. The decision was reversed on appeal, with the Court of Appeal holding the the moral quality of the broker's conduct allowed the court to grant the constructive trust remedy. It stated that the remedy was necessary in order to act as deterrent to activity in the real estate business that would undermine bonds of trust that enabled that industry to function. The broker appealed to the Supreme Court of Canada

Held: The appeal was dismissed

Per McLachlin J. (La Forest, Gonthier, Cory and Major JJ. concurring): Constructive trusts are not limited exclusively to cases involving unjust enrichment. Wrongful conduct by itself can give rise to the remedy if the following criteria are met: the defendant must have been under an equitable obligation, the defendant must have derived the assets from agency activities in breach of his equitable obligation to the plaintiff, the plaintiff must show a legitimate reason for seeking the remedy, either persona or related to the need to ensure that others like the defendant remain faithful to their duties, and there must be no factors (such as the rights of third parties) which would render imposition of a constructive trust unjust in all the circumstances of the case. In this case, the broker obtained the property as a result of a breach of his obligation to the client and as a direct result of his agency activities with respect to the client. As well, the client still had a desire to own the property and the remedy was necessary to ensure that real estate agents and others in positions of trust remain faithful to their duty of loyalty to their clients. To allow the broker to keep the property in these circumstances would have undermined the trust and confidence which underpins the institution of real estate brokerage. Finally, there were no factors which would make the imposition of a constructive trust unjust.

Per Sopinka J. (dissenting) (Iacobucci J. concurring): The granting of a constructive trust is a discretionary remedy and, as such, a decision of a trial judge on this issue can be overturned only if it can be shown that the judge made an error in principle. In this case, the trial judge did not commit any error in principle in rendering his decision

Recent case law had made it very clear that a constructive trust can be granted only in cases of unjust enrichment, which must be pecuniary in nature. In this case, there was no such enrichment.

. . . . .

Un courtier en immeuble a volontairement omis d'informer son client que le vendeur d'un immeuble commercial avait accepté sa contre-offre et s'est arrangé pour que son épouse en fasse l'acquisition. Le titre a ensuite été transféré au courtier et à son épouse en tant que cotitulaires. Lorsque le client a eu vent de la manoeuvre, il a entrepris une action contre le courtier pour manquement à son obligation de fiduciaire, avec des conclusions translatives de propriété en vertu de la doctrine de la fiducie par interprétation. Le client n'avait pas subi de dommages pécuniaires par suite des agissements du courtier, car l'immeuble avait subséquemment subi une dévaluation. Cependant, le client désirait toujours acquérir l'immeuble à cause du prestige lié à cette propriété.

Au procès, le juge du procès a estimé que le courtier avait manqué à son obligation de fiduciaire, mais a refusé d'accorder le redressement en vertu de la fiducie par interprétation puisque le courtier ne s'était pas enrichi par suite de l'acquisition de l'immeuble, celui-ci s'étant dévalué. Le jugement a été annulé par la Cour d'appel, qui a statué que la turpitude du courtier l'autorisait à accueillir le recours fondé sur la fiducie par interprétation. La Cour a conclu que ce redressement s'avérait nécessaire afin de dissuader les agissements dans le domaine du courtage immobilier qui nuiraient au lien de confiance, élément essentiel dans ce secteur d'activité. Le courtier a formé un pourvoi à la Cour suprême du Canada.

Arrêt: Le pourvoi a été rejeté.

McLachlin, J. (La Forest, Gonthier, Cory et Major, JJ., souscrivant) : Les fiducies par interprétation ne se limitent pas seulement aux cas d'enrichissement sans cause. En soi, l'inconduite peut donner ouverture à ce recours si les critères suivants sont rencontrés : le défendeur doit assumer une obligation équitable, le défendeur doit avoir distrait les biens objets de son mandat en violation de son obligation équitable envers le demandeur, le demandeur doit avoir une raison légitime d'entreprendre un tel recours, soit personnelle ou liée au besoin de s'assurer que d'autres dans la position du défendeur respectent leurs obligations et il ne doit pas exister d'autres facteurs (tels les droits des tiers) qui, dans les circonstances du litige, rendraient injuste l'imposition d'une fiducie par interprétation. En l'espèce, le courtier a obtenu l'immeuble à la suite d'une violation de son obligation envers son client et à la suitede ses activités en tant que mandataire pour le compte du client. En outre, le client désirait toujours acquérir l'immeuble et le recours s'avérait nécessaire pour s'assurer que les courtiers en immeuble, de même que d'autres personnes en situation de confiance, respectent leur obligation de loyauté envers leurs clients. En l'occurrence, permettre au courtier de conserver l'immeuble compromettrait le lien de confiance qui sous-tend l'institution du courtage immobilier. En terminant, il n'y avait aucun facteur qui rendait injuste l'imposition d'une fiducie par interprétation.

Sopinka, J. (dissident) (Iacobucci, J., souscrivant) : Accorder une fiducie par interprétation est un redressement discrétionnaire et, comme telle, la décision du juge du procès ne peut être annulée que s'il est démontré une erreur de principe de sa part. En l'espèce, le juge du procès n'a pas commis d'erreur de principe.

La jurisprudence récente a établi très clairement qu'une fiducie par interprétation ne peut être accordée que dans des cas d'enrichissement sans cause, de nature pécuniaire. Il n'existait pas de tel enrichissement dans ce dossier.

Table of Authorities

Cases considered by *McLachlin J.* (*La Forest, Gonthier, Cory* and *Major JJ.* concurring):

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Canadian Aero Service Ltd. v. O'Malley (1973), [1974] S.C.R. 592, 40 D.L.R. (3d) 371, 11 C.P.R. (2d) 206 (S.C.C.) — considered

Canson Enterprises Ltd. v. Boughton & Co., [1992] 1 W.W.R. 245, 9 C.C.L.T. (2d) 1, 39 C.P.R. (3d) 449, 131 N.R. 321, 85 D.L.R. (4th) 129, 61 B.C.L.R. (2d) 1, 6 B.C.A.C. 1, 13 W.A.C. 1, [1991] 3 S.C.R. 534, 43 E.T.R. 201 (S.C.C.) — considered

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APPEAL from judgment reported at [1995] 84 O.A.C. 390 , allowing appeal from (1991), 4 O.R. (3d) 51 (Gen. Div.) , additional reasons at (1991), 4 O.R. (3d) 51 at 71 (Gen. Div.) which refused to grant remedy of constructive trust for breach of fiduciary duty when no resulting unjust enrichment.

POURVOI à l'encontre d'un arrêt publié à [1995] 84 O.A.C. 390 , accueillant le pourvoi à l'encontre de (1991), 4 O.R. (3d) 51 (Gen. Div.) , motifs additionnels publié à (1991), 4 O.R. (3d) 51 à 71 (Div. Gén.), refusant le redressement en vertu de la fiducie par interprétation résultant de la violation de l'obligation fiduciaire lorsque aucun enrichissement sans cause n'en résulte.

***McLachlin J.* (La Forest, Gonthier, Cory and Major JJ. concurring):**

I

1 This appeal requires this Court to determine whether a real estate agent who buys for himself property for which he has been negotiating on behalf of a client, may be required to return the property to his client despite the fact that the client can show no loss. This raises the legal issue of whether a constructive trust over property may be imposed in the absence of enrichment of the defendant and corresponding deprivation of the plaintiff. In my view, this question should be answered in the affirmative.

II

2 The appellant Mr. Korkontzilas is a real estate broker. The respondent, Mr. Soulos, was his client. In 1984, Mr. Korkontzilas found a commercial building which he thought might interest Mr. Soulos. Mr. Soulos was interested in purchasing the building. Mr. Korkontzilas entered into negotiations on behalf of Mr. Soulos. He offered $250,000. The vendor, Dominion Life, rejected the offer and tendered a counter-offer of $275,000. Mr. Soulos rejected the counter-offer but "signed it back" at $260,000 or $265,000. Dominion Life advised Mr. Korkontzilas that it would accept $265,000. Instead of conveying this information to Mr. Soulos as he should have, Mr. Korkontzilas arranged for his wife, Panagiota Goutsoulas, to purchase the property using the name Panagiot Goutsoulas. Panagiot Goutsoulas then transferred the property to Panagiota and Fotios Korkontzilas as joint tenants. Mr. Soulos asked what had happened to the property. Mr. Korkontzilas told him to "forget about it"; the vendor no longer wanted to sell it and he would find him a better property. Mr. Soulos asked Mr. Korkontzilas whether he had had anything to do with the vendor's change of heart. Mr. Korkontzilas said he had not.

3 In 1987 Mr. Soulos learned that Mr. Korkontzilas had purchased the property for himself. He brought an action against Mr. Korkontzilas to have the property conveyed to him, alleging breach of fiduciary duty giving rise to a

constructive trust. He asserted that the property held special value to him because its tenant was his banker, and being one's banker's landlord was a source of prestige in the Greek community of which he was a member. However, Mr. Soulos abandoned his claim for damages because the market value of the property had, in fact, decreased from the time of the Korkontzilas purchase.

4 The trial judge found that Mr. Korkontzilas had breached a duty of loyalty to Mr. Soulos, but held that a constructive trust was not an appropriate remedy because Mr. Korkontzilas had purchased the property at market value and hence had not been "enriched": (1991), 4 O.R. (3d) 51, 19 R.P.R. (2d) 205 (Ont. Gen. Div.) (hereinafter cited to O.R.). The decision was reversed on appeal, Labrosse J.A. dissenting: (1995), 25 O.R. (3d) 257, 126 D.L.R. (4th) 637, 84 O.A.C. 390, 47 R.P.R. (2d) 221 (Ont. C.A.) (hereinafter cited to O.R.).

5 For the reasons that follow, I would dismiss the appeal. In my view, the doctrine of constructive trust applies and requires that Mr. Korkontzilas convey the property he wrongly acquired to Mr. Soulos.

III

6 The first question is what duties Mr. Korkontzilas owed to Mr. Soulos in relation to the property. This question returns us to the findings of the trial judge. The trial judge rejected the submission of Mr. Soulos that an agreement existed requiring Mr. Korkontzilas to present all properties in the Danforth area to him exclusively before other purchasers. He found, however, that Mr. Korkontzilas became the agent for Mr. Soulos when he prepared the offer which Mr. Soulos signed with respect to the property at issue. He further found that this agency relationship extended to reporting the vendor's response to Mr. Soulos. This relationship of agency was not terminated when the vendor made its counter-offer. The trial judge therefore concluded that Mr. Korkontzilas was acting as Mr. Soulos' agent at all material times.

7 The trial judge went on to state that the relationship of agent and principal is fiduciary in nature. He concluded that as agent to Mr. Soulos, Mr. Korkontzilas owed Mr. Soulos a "duty of loyalty". He found that Mr. Korkontzilas breached this duty of loyalty when he failed to refer the vendor's counter-offer to Mr. Soulos.

8 The Court of Appeal did not take issue with these conclusions. The majority did, however, differ from the trial judge on what consequences flowed from Mr. Korkontzilas' breach of the duty of loyalty.

IV

9 This brings us to the main issue on this appeal: what remedy, if any, does the law afford Mr. Soulos for Mr. Korkontzilas' breach of the duty of loyalty in acquiring the property in question for himself rather than passing the vendor's statement of the price it would accept on to his principal, Mr. Soulos?

10 At trial Mr. Soulos' only claim was that the property be transferred to him for the price paid by Mr. Korkontzilas, subject to adjustments for changes in value and losses incurred on the property since purchase. He abandoned his claim for damages at an early stage of the proceedings. This is not surprising, since Mr. Korkontzilas had paid market value for the property and had, in fact, lost money on it during the period he had held it. Still, Mr. Soulos maintained his desire to own the property.

11 Mr. Soulos argued that the property should be returned to him under the equitable doctrine of constructive trust. The trial judge rejected this claim, on the ground that constructive trust arises only where the defendant has been unjustly enriched by his wrongful act. The fact that damages offered Mr. Soulos no compensation was of no moment: "It would be anomalous to declare a constructive trust, in effect, because a remedy in damages is unsatisfactory, the plaintiff having suffered none" (p. 69). Furthermore, "it seems simply disproportionate and inappropriate to utilize the drastic remedy of a constructive trust where the plaintiff has suffered no damage" (p. 69). The trial judge added that nominal damages were inappropriate, damages having been waived, and that Mr. Soulos had mitigated his loss by buying other properties.

12 The majority of the Court of Appeal took a different view. Carthy J.A. held that the award of an equitable remedy is discretionary and dependent on all the facts before the court. In his view, however, the trial judge had exercised his discretion on a wrong principle. Carthy J.A. asserted that the moral quality of the defendant's act may dictate the court's intervention. Most real estate transactions involve one person acting gratuitously for the purchaser, while seeking commission from the vendor. The fiduciary duties of the agent would be meaningless if the agent could simply acquire the property at market value, and then deny that he or she is a constructive trustee because no damages are suffered. In such circumstances, equity will "intervene with a proprietary remedy to sustain the integrity of the laws which it supervises" (p. 261). Carthy J.A. conceded that Mr. Soulos' reason for desiring the property may seem "whimsical". But viewed against the broad context of real estate transactions, he found that the remedy of constructive trust in these circumstances serves a "salutary purpose". It enables the court to ensure that immoral conduct is not repeated, undermining the bond of trust that enables the industry to function. The majority accordingly ordered conveyance of the property subject to appropriate adjustments.

13 The difference between the trial judge and the majority in the Court of Appeal may be summarized as follows. The trial judge took the view that in the absence of established loss, Mr. Soulos had no action. To grant the remedy of constructive trust in the absence of loss would be "simply disproportionate and inappropriate", in his view. The majority in the Court of Appeal, by contrast, took a broader view of when a constructive trust could apply. It held that a constructive trust requiring reconveyance of the property could arise in the absence of an established loss in order to condemn the agent's improper act and maintain the bond of trust underlying the real estate industry and hence the "integrity of the laws" which a court of equity supervises.

14 The appeal thus presents two different views of the function and ambit of the constructive trust. One view sees the constructive trust exclusively as a remedy for clearly established loss. On this view, a constructive trust can arise only where there has been "enrichment" of the defendant and corresponding "deprivation" of the plaintiff. The other view, while not denying that the constructive trust may appropriately apply to prevent unjust enrichment, does not confine it to that role. On this view, the constructive trust may apply absent an established loss to condemn a wrongful act and maintain the integrity of the relationships of trust which underlie many of our industries and institutions.

15 It is my view that the second, broader approach to constructive trust should prevail. This approach best accords with the history of the doctrine of constructive trust, the theory underlying the constructive trust, and the purposes which the constructive trust serves in our legal system.

V

16 The appellants argue that this Court has adopted a view of constructive trust based exclusively on unjust enrichment in cases such as *Becker v. Pettkus*, [1980] 2 S.C.R. 834 (S.C.C.) . Therefore, they argue, a constructive trust cannot be imposed in cases like this where the plaintiff can demonstrate no deprivation and corresponding enrichment of the defendant.

17 The history of the law of constructive trust does not support this view. Rather, it suggests that the constructive trust is an ancient and eclectic institution imposed by law not only to remedy unjust enrichment, but to hold persons in different situations to high standards of trust and probity and prevent them from retaining property which in "good conscience" they should not be permitted to retain. This served the end, not only of doing justice in the case before the court, but of protecting relationships of trust and the institutions that depend on these relationships. These goals were accomplished by treating the person holding the property as a trustee of it for the wronged person's benefit, even though there was no true trust created by intention. In England, the trust thus created was thought of as a real or "institutional" trust. In the United States and recently in Canada, jurisprudence speaks of the availability of the constructive trust as a remedy; hence the remedial constructive trust.

18 While specific situations attracting a constructive trust have been identified, the older English jurisprudence offers no satisfactory limiting or unifying conceptual theory for the constructive trust. As D. W. M. Waters, *The Constructive Trust* (1964), at p. 39, puts it, the constructive trust "was never any more than a convenient and available language medium through which ... the obligations of parties might be expressed or determined". The constructive trust was used in English law "to link together a number of disparate situations ... on the basis that the obligations imposed by law in these situations might in some way be likened to the obligations which were imposed upon an express trustee": J. L. Dewar, "The Development of the Remedial Constructive Trust" (1981), 6 *Est. & Tr. Q.* 312, at p. 317, citing Waters, *supra* .

19 The situations in which a constructive trust was recognized in England include constructive trusts arising on breach of a fiduciary relationship, as well as trusts imposed to prevent the absence of writing from depriving a person of proprietary rights, to prevent a purchaser with notice from fraudulently retaining trust properties, and to enforce secret trusts and mutual wills. See Dewar, *supra* , at p. 334. The fiduciary relationship underlies much of the English law of constructive trust. As Waters, *supra* , at p. 33, writes: "the fiduciary relationship is clearly wed to the constructive trust over the whole, or little short of the whole, of the trust's operation". At the same time, not all breaches of fiduciary relationships give rise to a constructive trust. As L. S. Sealy, "Fiduciary Relationships", [1962] *Camb. L.J.* 69, at p. 73, states:

> The word "fiduciary," we find, is *not* definitive of a single class of relationships to which a fixed set of rules and principles apply. Each equitable remedy is available only in a limited number of fiduciary situations; and the mere statement that John is in a fiduciary relationship towards me means no more than that in some respects his position is trustee-like; it does not warrant the inference that any particular fiduciary principle or remedy can be applied. [Emphasis in original.]

Nor does the absence of a classic fiduciary relationship necessarily preclude a finding of a constructive trust; the wrongful nature of an act may be sufficient to constitute breach of a trust-like duty: see Dewar, *supra* , at pp. 322-23.

20 Canadian courts have never abandoned the principles of constructive trust developed in England. They have, however, modified them. Most notably, Canadian courts in recent decades have developed the constructive trust as a remedy for unjust enrichment. It is now established that a constructive trust may be imposed in the absence of wrongful conduct like breach of fiduciary duty, where three elements are present: (1) the enrichment of the defendant; (2) the corresponding deprivation of the plaintiff; and (3) the absence of a juristic reason for the enrichment: *Becker v. Pettkus, supra* .

21 This Court's assertion that a remedial constructive trust lies to prevent unjust enrichment in cases such as *Becker v. Pettkus* should not be taken as expunging from Canadian law the constructive trust in other circumstances where its availability has long been recognized. The language used makes no such claim. A. J. McClean, "Constructive and Resulting Trusts — Unjust Enrichment in a Common Law Relationship — *Pettkus v. Becker* " (1982), 16 *U.B.C.L. Rev.* 156 at p. 170, describes the ratio of *Becker v. Pettkus* as "a modest enough proposition". He goes on: "It would be wrong ... to read it as one would read the language of a statute and limit further development of the law".

22 Other scholars agree that the constructive trust as a remedy for unjust enrichment does not negate a finding of a constructive trust in other situations. D. M. Paciocco, "The Remedial Constructive Trust: A Principled Basis for Priorities over Creditors, (1989), 68 *Can. Bar Rev.* 315, at p. 318, states: "the constructive trust that is used to remedy unjust enrichment must be distinguished from the other types of constructive trusts known to Canadian law prior to 1980". Paciocco asserts that unjust enrichment is not a necessary condition of a constructive trust (at p. 320):

> ... in the largest traditional category, the fiduciary constructive trust, there need be no deprivation experienced by the particular plaintiff. The constructive trust is imposed to raise the morality of the marketplace generally, with the beneficiaries of some of these trusts receiving what can only be described as a windfall.

23 Dewar, *supra* , holds a similar view (at p. 332):

> While it is unlikely that Canadian courts will abandon the learning and the classifications which have grown up in connection with the English constructive trust, it is submitted that the adoption of the American style constructive trust by the Supreme Court of Canada in *Pettkus v. Becker* will profoundly influence the future development of Canadian trust law.

Dewar, *supra* , at pp. 332-33, goes on to state: "In English and Canadian law there is no general agreement as to precisely which situations give rise to a constructive trust, although there are certain general categories of cases in which it is agreed that a constructive trust does arise". One of these is to correct fraudulent or disloyal conduct.

24 M. M. Litman, "The Emergence of Unjust Enrichment as a Cause of Action and the Remedy of Constructive Trust", (1988), 26 *Alta. L. Rev.* 407, at p. 414, sees unjust enrichment as a useful tool in rationalizing the traditional categories of constructive trust. Nevertheless he opines that it would be a "significant error" to simply ignore the traditional principles of constructive trust. He cites a number of Canadian cases subsequent to *Becker v. Pettkus, supra* , which impose constructive trusts for wrongful acquisition of property, even in the absence of unjust enrichment and correlative deprivation, and concludes that the constructive trust "cannot always be explained by the unjust enrichment model of constructive trust" (p. 416). In sum, the old English law remains part of contemporary Canadian law and guides its development. As La Forest J.A. (as he then was) states in *White v. Central Trust Co.* (1984), 17 E.T.R. 78 (N.B. C.A.) , at p. 90, cited by Litman, *supra* , the courts "will not venture far onto an uncharted sea when they can administer justice from a safe berth".

25 I conclude that the law of constructive trust in the common law provinces of Canada embraces the situations in which English courts of equity traditionally found a constructive trust as well as the situations of unjust enrichment recognized in recent Canadian jurisprudence.

VI

26 Various principles have been proposed to unify the situations in which the English law found constructive trust. R. Goff and G. Jones, *The Law of Restitution* (3rd ed. 1986), at p. 61, suggest that unjust enrichment is such a theme. However, unless "enrichment" is interpreted very broadly to extend beyond pecuniary claims, it does not explain all situations in which the constructive trust has been applied. As McClean, *supra* , at p. 168, states: "however satisfactory [the unjust enrichment theory] may be for other aspects of the law of restitution, it may not be wide enough to cover all types of constructive trust." McClean goes on to note the situation raised by this appeal: "In some cases, where such a trust is imposed the trustee may not have obtained any benefit at all; this could be the case, for example, when a person is held to be a trustee *de son tort* . A plaintiff may not always have suffered a loss." McClean concludes (at pp. 168-69): "Unjust enrichment may not, therefore, satisfactorily explain all types of restitutionary claims".

27 McClean, among others, regards the most satisfactory underpinning for unjust enrichment to be the concept of "good conscience" which lies at "the very foundation of equitable jurisdiction" (p. 169):

> "Safe conscience" and "natural justice and equity" were two of the criteria referred to by Lord Mansfield in *Moses v. MacFerlan* (1760), 2 Burr. 1005, 97 E.R. 676 (K.B.) in dealing with an action for money had and received, the prototype of a common law restitutionary claim. "Good conscience" has a sound basis in equity, some basis in common law, and is wide enough to encompass constructive trusts where the defendant has not obtained a benefit or where the plaintiff has not suffered a loss. It is, therefore, as good as, or perhaps a better, foundation for the law of restitution than is unjust enrichment.

28 Other scholars agree with McClean that good conscience may provide a useful way of unifying the different forms of constructive trust. Litman, *supra* , adverts to the "natural justice and equity" or "good conscience" trust "which operates as a remedy for wrongs which are broader in concept than unjust enrichment" and goes on to state that this may be viewed as the underpinning of the various institutional trusts as well as the unjust enrichment restitutionary constructive trust (at pp. 415-16).

29 Good conscience as the unifying concept underlying constructive trust has attracted the support of many jurists. Edmund Davies L.J. suggested that the concept of a "want of probity" in the person upon whom the constructive trust is imposed provides "a useful touchstone in considering circumstances said to give rise to constructive trusts": *Carl-Zeiss-Stiftung v. Herbert Smith & Co. (No. 2)*, [1968] 2 Ch. 276 (Eng. C.A.) . Cardozo J. similarly endorsed the unifying theme of good conscience in *Beatty v. Guggenheim Exploration Co.*, 122 N.E. 378 (U.S. 1919), at p. 380:

> A constructive trust is the formula through which the conscience of equity finds expression. *When property has been acquired in such circumstances that the holder of the legal title may not in good conscience retain the beneficial interest, equity converts him into a trustee* . [Emphasis added.]

30 Lord Denning M.R. expressed similar views in a series of cases applying the constructive trust as a remedy for wrong-doing: see *Neale v. Willis* (1968), 112 Sol. Jo. 521 (Eng. C.A.) ; *Binions v. Evans*, [1972] Ch. 359 (Eng. C.A.) ; *Hussey v. Palmer*, [1972] 1 W.L.R. 1286 (Eng. C.A.) . In *Binions* , referring to the statement by Cardozo J., *supra* , Denning M.R. stated that the court would impose a constructive trust "for the simple reason that it would be utterly inequitable for the plaintiffs to turn the defendant out contrary to the stipulation subject to which they took the premises" (p. 368). In *Hussey* , he said the following of the constructive trust (at pp. 1289-90): "By whatever name it is described, it is a trust imposed by law whenever justice and good conscience require it".

31 Many English scholars have questioned Lord Denning's expansive statements on constructive trust. Nevertheless, he is not alone: Bingham J. similarly referred to good conscience as the basis for equitable intervention in *Neste Oy v. Lloyd's Bank Ltd.*, [1983] 2 Lloyd's Rep. 658 (Eng. C.A.) .

32 The New Zealand Court of Appeal also appears to have accepted good conscience as the basis for imposing a constructive trust in *Elders Pastoral Ltd. v. Bank of New Zealand* (1989), 2 N.Z.L.R. 180 . Cooke P., at pp. 185-86, cited the following passage from Bingham J.'s reasons in *Neste Oy, supra* , at p. 666:

> Given the situation of [the defendants] when the last payment was received, any reasonable and honest directors of that company (or the actual directors had they known of it) would, I feel sure, have arranged for the repayment of that sum to the plaintiffs without hesitation or delay. It would have seemed little short of sharp practice for [the defendants] to take any benefit from the payment, and it would have seemed contrary to any ordinary notion of fairness that the general body of creditors should profit from the accident of a payment made at a time when there was bound to be a total failure of consideration. Of course it is true that insolvency always causes loss and perfect fairness is unattainable. The bank, and other creditors, have their legitimate claims. *It nonetheless seems to me that at the time of its receipt [the defendants] could not in good conscience retain this payment and that accordingly a constructive trust is to be inferred* . [Emphasis added.]

Cooke P. concluded simply (at p. 186): "I do not think that in conscience the stock agents can retain this money." *Elders* has been taken to stand for the proposition that even in the absence of a fiduciary relationship or unjust enrichment, conduct contrary to good conscience may give rise to a remedial constructive trust: see *Mogal Corp. v. Australasia Investment Co. (In Liquidation)* (1990), 3 N.Z.B.L.C. 101 , 783; J. Dixon, "The Remedial Constructive Trust Based on Unconscionability in the New Zealand Commercial Environment" (1995), 7 *Auck. U. L. Rev.* 147, at pp. 157-58. Although the Judicial Committee of the Privy Council rejected the creation of a constructive trust on grounds of good conscience in *Goldcorp Exchange Ltd., Re*, [1994] 2 All E.R. 806 (New Zealand P.C.) , the fact remains that good conscience is a theme underlying constructive trust from its earliest times.

33 Good conscience addresses not only fairness between the parties before the court, but the larger public concern of the courts to maintain the integrity of institutions like fiduciary relationships which the courts of equity supervised. As La Forest J. states in *Hodgkinson v. Simms*, [1994] 3 S.C.R. 377 (S.C.C.) , at p. 453:

> The law of fiduciary duties has always contained within it an element of deterrence. This can be seen as early as *Keech* in the passage cited *supra* ; see also *Canadian Aero, supra* , at pp. 607 and 610; *Canson, supra* , at p. 547,

> *per* McLachlin J. In this way the law is able to monitor a given relationship society views as socially useful while avoiding the necessity of formal regulation that may tend to hamper its social utility.

The constructive trust imposed for breach of fiduciary relationship thus serves not only to do the justice between the parties that good conscience requires, but to hold fiduciaries and people in positions of trust to the high standards of trust and probity that commercial and other social institutions require if they are to function effectively.

34 It thus emerges that a constructive trust may be imposed where good conscience so requires. The inquiry into good conscience is informed by the situations where constructive trusts have been recognized in the past. It is also informed by the dual reasons for which constructive trusts have traditionally been imposed: to do justice between the parties and to maintain the integrity of institutions dependent on trust-like relationships. Finally, it is informed by the absence of an indication that a constructive trust would have an unfair or unjust effect on the defendant or third parties, matters which equity has always taken into account. Equitable remedies are flexible; their award is based on what is just in all the circumstances of the case.

35 Good conscience as a common concept unifying the various instances in which a constructive trust may be found has the disadvantage of being very general. But any concept capable of embracing the diverse circumstances in which a constructive trust may be imposed must, of necessity, be general. Particularity is found in the situations in which judges in the past have found constructive trusts. A judge faced with a claim for a constructive trust will have regard not merely to what might seem "fair" in a general sense, but to other situations where courts have found a constructive trust. The goal is but a reasoned, incremental development of the law on a case-by-case basis.

36 The situations which the judge may consider in deciding whether good conscience requires imposition of a constructive trust may be seen as falling into two general categories. The first category concerns property obtained by a wrongful act of the defendant, notably breach of fiduciary obligation or breach of duty of loyalty. The traditional English institutional trusts largely fall under but may not exhaust (at least in Canada) this category. The second category concerns situations where the defendant has not acted wrongfully in obtaining the property, but where he would be unjustly enriched to the plaintiff's detriment by being permitted to keep the property for himself. The two categories are not mutually exclusive. Often wrongful acquisition of property will be associated with unjust enrichment, and vice versa. However, either situation alone may be sufficient to justify imposition of a constructive trust.

37 In England the law has yet to formally recognize the remedial constructive trust for unjust enrichment, although many of Lord Denning's pronouncements pointed in this direction. The courts do, however, find constructive trusts in circumstances similar to those at bar. Equity traditionally recognized the appropriateness of a constructive trust for breach of duty of loyalty simpliciter. The English law is summarized by Goff and Jones, *The Law of Restitution, supra* , at p. 643:

> A fiduciary may abuse his position of trust by diverting a contract, purchase or other opportunity from his beneficiary to himself. If he does so, he is deemed to hold that contract, purchase, or opportunity on trust for the beneficiary.

P. Birks, *An Introduction to the Law of Restitution* (1985) (at pp. 330; 338-43) agrees. He suggests that cases of conflict of interest not infrequently may give rise to constructive trust, absent unjust enrichment. Birks distinguishes between anti-enrichment wrongs and anti-harm wrongs (at p. 340). A fiduciary acting in conflict of interest represents a risk of actual or potential harm, even though his misconduct may not always enrich him. A constructive trust may accordingly be ordered.

38 Both categories of constructive trust are recognized in the United States; although unjust enrichment is sometimes cited as the rationale for the constructive trust in the U.S., in fact its courts recognize the availability of constructive trust to require the return of property acquired by wrongful act absent unjust enrichment of the defendant and reciprocal deprivation of the plaintiff. Thus the authors of *Scott on Trusts* (3rd ed. 1967), vol. V, at p. 3410, state that the constructive

trust "is available where property is obtained by mistake or by fraud or by other wrong". Or as Cardozo C.J. put it, "[a] constructive trust is, then, the remedial device through which preference of self is made subordinate to loyalty to others": *Meinhard v. Salmon* (1928), 164 N.E. 545 (U.S. 1928), at p. 548, cited in *Scott on Trusts, supra* , at p. 3412. *Scott on Trusts, supra* , at p. 3418, states that there are cases "in which a constructive trust is enforced against a defendant, although the loss to the plaintiff is less than the gain to the defendant or, indeed, where there is no loss to the plaintiff".

39 Canadian courts also recognize the availability of constructive trusts for both wrongful acquisition of property and unjust enrichment. Applying the English law, they have long found constructive trusts as a consequence of wrongful acquisition of property, for example by fraud or breach of fiduciary duty. More recently, Canadian courts have recognized the availability of the American-style remedial constructive trust in cases of unjust enrichment: *Becker v. Pettkus, supra* . However, since *Becker v. Pettkus* Canadian courts have continued to find constructive trusts where property has been wrongfully acquired, even in the absence of unjust enrichment. While such cases appear infrequently since few choose to litigate absent pecuniary loss, they are not rare.

40 Litman, *supra* , at p. 416, notes that in "the post-*Pettkus v. Becker* era there are numerous cases where courts have used the institutional constructive trust without adverting to or relying on unjust enrichment". The imposition of a constructive trust in these cases is justified not on grounds of unjust enrichment, but on the ground that the defendant's wrongful act requires him to restore the property thus obtained to the plaintiff.

41 Thus in *Ontario (Wheat Producers' Marketing Board) v. Royal Bank* (1984), 9 D.L.R. (4th) 729 (Ont. C.A.) , a constructive trust was imposed on a bank which received money with actual knowledge that it belonged to someone other than the depositor.

42 Again, in *MacMillan Bloedel Ltd. v. Binstead* (1983), 14 E.T.R. 269 (B.C. S.C.) , a constructive trust was imposed on individuals who knowingly participated in a breach of fiduciary duty despite a finding that unjust enrichment would not warrant the imposition of a trust because the plaintiff company could not be said to have suffered a loss or deprivation since its own policy precluded it from receiving the profits. Dohm J. (as he then was) stated that the constructive trust was required "not to balance the equities but to ensure that trustees and fiduciaries remain faithful and that those who assist them in the breaches of their duty are called to account" (p. 302).

43 I conclude that in Canada, under the broad umbrella of good conscience, constructive trusts are recognized both for wrongful acts like fraud and breach of duty of loyalty, as well as to remedy unjust enrichment and corresponding deprivation. While cases often involve both a wrongful act and unjust enrichment, constructive trusts may be imposed on either ground: where there is a wrongful act but no unjust enrichment and corresponding deprivation; or where there is an unconscionable unjust enrichment in the absence of a wrongful act, as in *Becker v. Pettkus, supra* . Within these two broad categories, there is room for the law of constructive trust to develop and for greater precision to be attained, as time and experience may dictate.

44 The process suggested is aptly summarized by McClean, *supra* , at pp. 167-70:

> The law [of constructive trust] may now be at a stage where it can distill from the specific examples a few general principles, and then, by analogy to the specific examples and within the ambit of the general principle, create new heads of liability. That, it is suggested, is not asking the courts to embark on too dangerous a task, or indeed on a novel task. In large measure it is the way that the common law has always developed.

VII

45 In *Becker v. Pettkus, supra* , this Court explored the prerequisites for a constructive trust based on unjust enrichment. This case requires us to explore the prerequisites for a constructive trust based on wrongful conduct. Extrapolating from the cases where courts of equity have imposed constructive trusts for wrongful conduct, and from a discussion of the criteria considered in an essay by Roy Goode, "Property and Unjust Enrichment", in Andrew Burrows ed., *Essays on the Law of Restitution* (1991), I would identify four conditions which generally should be satisfied:

(1) The defendant must have been under an equitable obligation, that is, an obligation of the type that courts of equity have enforced, in relation to the activities giving rise to the assets in his hands;

(2) The assets in the hands of the defendant must be shown to have resulted from deemed or actual agency activities of the defendant in breach of his equitable obligation to the plaintiff;

(3) The plaintiff must show a legitimate reason for seeking a proprietary remedy, either personal or related to the need to ensure that others like the defendant remain faithful to their duties and;

(4) There must be no factors which would render imposition of a constructive trust unjust in all the circumstances of the case; e.g., the interests of intervening creditors must be protected.

VIII

46 Applying this test to the case before us, I conclude that Mr. Korkontzilas' breach of his duty of loyalty sufficed to engage the conscience of the court and support a finding of constructive trust for the following reasons.

47 First, Mr. Korkontzilas was under an equitable obligation in relation to the property at issue. His failure to pass on to his client the information he obtained on his client's behalf as to the price the vendor would accept on the property and his use of that information to purchase the property instead for himself constituted breach of his equitable duty of loyalty. He allowed his own interests to conflict with those of his client. He acquired the property wrongfully, in flagrant and inexcusable breach of his duty of loyalty to Mr. Soulos. This is the sort of situation which courts of equity, in Canada and elsewhere, have traditionally treated as involving an equitable duty, breach of which may give rise to a constructive trust, even in the absence of unjust enrichment.

48 Second, the assets in the hands of Mr. Korkontzilas resulted from his agency activities in breach of his equitable obligation to the plaintiff. His acquisition of the property was a direct result of his breach of his duty of loyalty to his client, Mr. Soulos.

49 Third, while Mr. Korkontzilas was not monetarily enriched by his wrongful acquisition of the property, ample reasons exist for equity to impose a constructive trust. Mr. Soulos argues that a constructive trust is required to remedy the deprivation he suffered because of his continuing desire, albeit for non-monetary reasons, to own the particular property in question. No less is required, he asserts, to return the parties to the position they would have been in had the breach not occurred. That alone, in my opinion, would be sufficient to persuade a court of equity that the proper remedy for Mr. Korkontzilas' wrongful acquisition of the property is an order that he is bound as a constructive trustee to convey the property to Mr. Soulos.

50 But there is more. I agree with the Court of Appeal that a constructive trust is required in cases such as this to ensure that agents and others in positions of trust remain faithful to their duty of loyalty: see *Hodgkinson v. Simms, supra, per* La Forest J. If real estate agents are permitted to retain properties which they acquire for themselves in breach of a duty of loyalty to their clients provided they pay market value, the trust and confidence which underpins the institution of real estate brokerage will be undermined. The message will be clear: real estate agents may breach their duties to their clients and the courts will do nothing about it, unless the client can show that the real estate agent made a profit. This will not do. Courts of equity have always been concerned to keep the person who acts on behalf of others to his ethical mark; this Court should continue in the same path.

51 I come finally to the question of whether there are factors which would make imposition of a constructive trust unjust in this case. In my view, there are none. No third parties would suffer from an order requiring Mr. Korkontzilas to convey the property to Mr. Soulos. Nor would Mr. Korkontzilas be treated unfairly. Mr. Soulos is content to make all necessary financial adjustments, including indemnification for the loss Mr. Korkontszilas has sustained during the years he has held the property.

52 I conclude that a constructive trust should be imposed. I would dismiss the appeal and confirm the order of the Court of Appeal that the appellants convey the property to the respondent, subject to appropriate adjustments. The respondent is entitled to costs throughout.

***Sopinka J.* (dissenting) (Iacobucci J. concurring):**

53 I have read the reasons of my colleague McLachlin J. While I agree with her conclusion that a breach of a fiduciary duty was made out herein, I disagree with her analysis concerning the appropriate remedy. In my view, she errs in upholding the decision of the majority of the Court of Appeal to overturn the trial judge and impose a constructive trust over the property in question. There are two broad reasons for my conclusion. First, the order of a constructive trust is a discretionary matter and, as such, is entitled to appellate deference. Given that the trial judge did not err in principle in declining to make such an order, appellate courts should not interfere with the exercise of his discretion. Second, even if appellate review were appropriate in the present case, a constructive trust as a remedy is not available where there has been no unjust enrichment. The main source of my disagreement with McLachlin J. arises in consideration of the second point, but in order to address the reasons of the majority in the court below as well, I will consider both of these issues in turn.

Standard of Review and the Exercise of Discretion

54 It is a matter of settled law that appellate courts should generally not interfere with orders exercised within a trial judge's discretion. Only if the discretion has been exercised on the basis of an erroneous principle should the order be overturned on appeal: see *Donkin v. Bugoy*, [1985] 2 S.C.R. 85 (S.C.C.) . As acknowledged by the majority in the Court of Appeal ((1995), 25 O.R. (3d) 257 (Ont. C.A.) , at p. 259), the decision to order a constructive trust is a matter of discretion. In *International Corona Resources Ltd. v. LAC Minerals Ltd.*, [1989] 2 S.C.R. 574 (S.C.C.) , the majority held that the order of a constructive trust in response to a breach of a fiduciary duty would depend on all the circumstances. La Forest J. stated at p. 674:

> In the case at hand, the restitutionary claim has been made out. The Court can award either a proprietary remedy, namely that Lac hand over the Williams property, or award a personal remedy, namely a monetary award. ... [A constructive trust] is but one remedy, and will only be imposed in appropriate circumstances.

The discretionary approach to constructive trusts is also consistent with the approach to equitable remedies generally: see *Canson Enterprises Ltd. v. Boughton & Co.*, [1991] 3 S.C.R. 534 (S.C.C.) , at p. 585.

55 Given that ordering a constructive trust is a discretionary matter, it is necessary to show an error in principle on the part of the trial judge in order to overturn the judge's decision not to order such a remedy. In my view, the trial judge committed no such error.

56 The majority of the Court of Appeal apparently found that the trial judge erred in failing to consider the moral blameworthiness of the appellants' actions. Similarly, McLachlin J. would hold that a constructive trust was appropriate in the present case simply because of considerations of "good conscience". In my view, the trial judge considered the moral quality of the appellants' actions and thus there is no room for appellate intervention on this ground. He stated ((1991), 4 O.R. (3d) 51 (Ont. Gen. Div.) , at p. 69) that, while "[n]o doubt the maintenance of commercial morality is an element of public policy and a legitimate concern of the court", morality should generally not invite the intervention of the court, except where it is required in aid of enforcing some legal right. Put another way, in my view the trial judge was of the opinion that where there is otherwise no justification for ordering a constructive trust or any other remedy, the morality of the act will not alone justify such an order, which statement of the law is in my view correct.

57 The majority of the Court of Appeal stated (at pp. 259-60) that the principles set out by the trial judge may be applicable where there are alternative remedies, but are questionable where only one remedy is available, as in the present case. I do not accept this contention. If a constructive trust is held to be inappropriate where there are a variety

of remedies available, I cannot understand the principle behind the conclusion that such a remedy may be appropriate where it is the only remedy available. The trial judge has a discretion to order a constructive trust, or not to order one, and this discretion should not be affected by the number of available remedies. In the present case, the plaintiff withdrew his claim for damages. While compensatory damages were unavailable since the plaintiff suffered no pecuniary loss (which I will discuss further below in assessing whether a constructive trust could have been ordered), the plaintiff could have sought exemplary damages — his decision not to do so should not bind the trial judge's discretion with respect to the order of a constructive trust.

58 The trial judge put significant emphasis on the absence of pecuniary gains in concluding that he would not order a constructive trust. For the reasons which I set out in detail below, I am of the opinion that the trial judge was correct in this regard. On the other hand, the majority of the Court of Appeal and McLachlin J. hold that the trial judge erred in improperly appreciating the deterrence role of a constructive trust in the present case. In my view, consideration of deterrence fails to disclose any error in principle on the part of the trial judge. Deterrence, like the morality of the acts in question, may be relevant to the exercise of discretion with respect to the remedy for a breach of a fiduciary duty (see, e.g., *Hodgkinson v. Simms*, [1994] 3 S.C.R. 377 (S.C.C.) , at pp. 421 and 453), but the trial judge in the present case did not fail to consider deterrence in deciding whether to order a constructive trust. As noted above, he stated that while "maintenance of commercial morality is ... a legitimate concern of the court" (p. 69), it would not alone justify ordering a remedy in the present case. In my view, his mention of the "maintenance of commercial morality" indicates that the judge considered deterrence, but held that it alone could not justify a remedy in the present case. Thus, even if failure to consider deterrence could be considered an error in principle, the trial judge in the present case did not so err.

59 In my view, the trial judge committed no error in principle which could justify a decision to set aside his judgment and order a constructive trust. Even if the trial judge did commit some error in principle, however, in my view the remedy of a constructive trust was not available on the facts of the present case. That is, even if no deference is owed to the trial judge, the majority below erred in ordering a constructive trust and the appeal should be allowed. The following are my reasons for this conclusion.

Unjust Enrichment and the Availability of a Constructive Trust

60 McLachlin J. would hold that there are two general circumstances in which a constructive trust may be ordered: where there has been unjust enrichment and where there has been an absence of "good conscience". While unjust enrichment and the absence of "good conscience" may both be present in a particular case, McLachlin J. is of the view that either element individually is sufficient to order a constructive trust. By failing to consider the "good conscience" ground on its own, McLachlin J. finds that the trial judge erred. I respectfully disagree with this finding. In my view, recent case law in this Court is very clear that a constructive trust may *only* be ordered where there has been an unjust enrichment. For example, passages in *LAC Minerals, supra* , set out the circumstances in which an order of a constructive trust might be appropriate. In my opinion, it is clear from that decision that a constructive trust is not available as a remedy unless there has been an unjust enrichment. La Forest J. stated at pp. 673-74:

> This Court has recently had occasion to address the circumstances in which a constructive trust will be imposed in *Hunter Engineering Co. v. Syncrude Canada Ltd.*, [1989] 1 S.C.R. 426 . There, the Chief Justice discussed the development of the constructive trust over 200 years from its original use in the context of fiduciary relationships, through to *Pettkus v. Becker* , [[1980] 2 S.C.R. 834], where the Court moved to the modern approach with the constructive trust as a remedy for unjust enrichment. He identified that *Pettkus v. Becker, supra* , set out a two-step approach. *First, the Court determines whether a claim for unjust enrichment is established, and then, secondly, examines whether in the circumstances a constructive trust is the appropriate remedy to redress that unjust enrichment* . In *Hunter Engineering Co. v. Syncrude Canada Ltd.* , a constructive trust was refused, not on the basis that it would not have been available between the parties (though in my view it may not have been appropriate), but rather on the basis that the claim for unjust enrichment had not been made out, so no remedial question arose.

> In the case at hand, the restitutionary claim has been made out. The Court can award either a proprietary remedy, namely that Lac hand over the Williams property, or award a personal remedy, namely a monetary award. While, as the Chief Justice observed, "*The principle of unjust enrichment lies at the heart of the constructive trust* ": see *Pettkus v. Becker* , at p. 847, the converse is not true. The constructive trust does not lie at the heart of the law of restitution. [Emphasis added.]

La Forest J. added at p. 678:

> *Much of the difficulty disappears if it is recognized that in this context the issue of the appropriate remedy only arises once a valid restitutionary claim has been made out* . The constructive trust awards a right in property, but that right can only arise once a right to relief has been established. [Emphasis added.]

61 In *Brissette v. Westbury Life Insurance Co.*, [1992] 3 S.C.R. 87 (S.C.C.) , the majority cited some of the passages above from *Lac* with approval and held at p. 96 that, "[t]he requirement of unjust enrichment is fundamental to the use of a constructive trust."

62 Citing only *Pettkus, supra* , specifically, McLachlin J. states at para. 21 that it and other cases should not be taken to expunge from Canadian law the constructive trust in circumstances where there has not been unjust enrichment. With respect, I do not see how statements such as "The requirement of unjust enrichment is fundamental to the use of a constructive trust" could do anything but expunge from Canadian law the use of constructive trusts where there has been no enrichment. Unjust enrichment has been repeatedly stated to be a *requirement* for a constructive trust; thus to order one where there has been no unjust enrichment would clearly depart from settled law.

63 Even aside from the case law, in my view, the unavailability of a constructive trust in the absence of unjust enrichment is consistent with the constructive trust's remedial role. The respondent submitted that if no remedy is available in the present case, there would inappropriately be a right without a remedy. I disagree. Clearly, the beneficiary has a right to have the fiduciary adhere to its duty, and *if damages are suffered* , the beneficiary has a right to a remedy. In my view, this is analogous to remedial principles found elsewhere in the private law. Even if a duty is owed and breached in other legal contexts, there is no remedy unless a loss has been suffered. I may owe a duty to my neighbour to shovel snow off my walk, and I may breach that duty, but if my neighbour does not suffer any loss because of the breached duty, there is no tort and no remedy. Similarly, I may have a contractual duty to supply goods at a specific date for a specific price, but if I do not and the other party is able to purchase the same goods at the contract price at the same time and place, the party has not suffered damage and no remedy is available. It is entirely consistent with these rules to state that even if a fiduciary breaches a duty, if the fiduciary is not unjustly enriched by the breach, there is no remedy.

64 Remedial principles generally thus support the rule against a constructive trust where there has been no unjust enrichment. The rule is also supported, in my view, by specific consideration of the principles governing constructive trusts set out in *LAC Minerals* . In *LAC Minerals* , La Forest J. stated that, even where there has been unjust enrichment, the constructive trust will be an exceptional remedy; the usual approach would be to award damages. He stated at p. 678:

> In the vast majority of cases a constructive trust will not be the appropriate remedy. Thus, in *Hunter Engineering Co. v. Syncrude Canada Ltd., supra* , had the restitutionary claim been made out, there would have been no reason to award a constructive trust, as the plaintiff's claim could have been satisfied simply by a personal monetary award; *a constructive trust should only be awarded if there is reason to grant to the plaintiff the additional rights that flow from recognition of a right of property* . [Emphasis added.]

65 La Forest J. thus held that generally an aggrieved beneficiary will only be entitled to damages, not to the property itself. This implies that the beneficiary does not generally have a right to the property in question, but rather has a right to receive the value of the gains resulting from the acquisition of the property. Following this reasoning, if the value of the gains is zero, that is, there is no unjust enrichment, the beneficiary will not have a right to a remedy. Consequently, where there has been no unjust enrichment, there is no right to a constructive trust or any other remedy.

66 While, in my view, recent decisions of this Court and the principles underlying them settle the matter, McLachlin J. cites other Canadian case law in concluding that constructive trusts may be ordered even where there has not been unjust enrichment. She cites three lower court decisions which she claims involved the award of a constructive trust absent unjust enrichment. With respect, I do not read any one of these cases as supporting her claim. An unjust enrichment exists where there has been an enrichment of the defendant, a corresponding deprivation experienced by the plaintiff and the absence of any juristic reason for the enrichment: *Becker v. Pettkus*, [1980] 2 S.C.R. 834 (S.C.C.) ; *Syncrude Canada Ltd. v. Hunter Engineering Co.*, [1989] 1 S.C.R. 426 (S.C.C.) . McLachlin J. fails to cite a case where a remedial constructive trust was ordered absent such an enrichment.

67 In *Ontario (Wheat Producers' Marketing Board) v. Royal Bank* (1984), 9 D.L.R. (4th) 729 (Ont. C.A.) , a constructive trust was imposed on a bank which received money with actual knowledge that it belonged to someone other than the depositor. The bank was a secured creditor of the depositor, which depositor was in financial difficulty at the time of the deposits. Clearly, this case involved an unjust enrichment: the bank benefitted by gaining rights over the deposited money, as well as by increasing the likelihood of repayment of the depositor's credit; the plaintiff (a corporation whose agent, the depositor, breached his fiduciary obligations) was deprived of its right to its money; and there was no juristic reason for the enrichment. Thus, the order of a constructive trust responded to an unjust enrichment, whether or not the court adverted to such doctrine.

68 *MacMillan Bloedel Ltd. v. Binstead* (1983), 14 E.T.R. 269 (B.C. S.C.) is also, in my view, a case of unjust enrichment. In this case, a fiduciary to a corporation breached his duty by engaging in self-dealing without disclosing his interest. A constructive trust was imposed over the secret profits even though the plaintiff organization, because of its internal policy, could not have realized the profits itself. While the fiduciary was plainly enriched, the trial judge and McLachlin J. conclude that since the plaintiff could not have realized the profits, there was no "corresponding deprivation" and therefore no unjust enrichment.

69 I disagree with McLachlin J. that there was no unjust enrichment in *MacMillan Bloedel Ltd.* First of all, courts have consistently treated fiduciaries' profits explicitly as unjust enrichment, whether or not the beneficiary could have earned the profits itself. For example, in *Reading v. R.*, [1948] 2 All E.R. 27 (Eng. K.B.) , aff'd [1949] 2 All E.R. 68 (Eng. C.A.) , aff'd [1951] 1 All E.R. 617 (Eng. H.L.) , Denning J. stated at p. 28:

> It matters not that the master has not lost any profit, nor suffered any damage, nor does it matter that the master could not have done the act himself. If the servant has *unjustly enriched himself* by virtue of his service without his master's sanction, the law says that he ought not to be allowed to keep the money. ... [Emphasis added.]

In *Canadian Aero Service Ltd. v. O'Malley* (1973), [1974] S.C.R. 592 (S.C.C.) , at pp. 621-22, Laskin J., as he then was, stated:

> Liability of O'Malley and Zarzycki for breach of fiduciary duty *does not depend upon proof by Canaero that, but for their intervention, it would have obtained the Guyana contract* ; nor is it a condition of recovery of damages that Canaero establish what its profit would have been or what it has lost by failing to realize the corporate opportunity in question. It is entitled to compel the faithless fiduciaries to answer for their default according to their gain. Whether the damages awarded here be viewed as an accounting of profits or, what amounts to the same thing, *as based on unjust enrichment* , I would not interfere with the quantum. [Emphasis added.]

Reading and *Canadian Aero Service Ltd.* are clear: the characterization of the profits earned by a fiduciary in breach of duty is one of unjust enrichment, whether or not the corporation could have earned the profits itself. Thus, *MacMillan Bloedel Ltd.* involved unjust enrichment, contrary to McLachlin J.'s assertion.

70 I wish to add that the treatment of the profits as unjust enrichment in *Reading, O'Malley* , and *MacMillan Bloedel Ltd.* is not inconsistent with the general rules governing unjust enrichment. The plaintiff in each case had a right to have the fiduciary adhere to his duty. When the defendant breached that duty, the profits earned as a result of that breach

are essentially treated in equity as belonging to the corporation, whether or not the corporation could have earned those profits in the absence of the breach. As an example of the proprietary analogy, Denning M.R. stated at p. 856 in *Phipps v. Boardman*, [1965] 1 All E.R. 849 (Eng. C.A.) , aff'd [1966] 3 All E.R. 721 (U.K. H.L.) , that:

> [W]ith *information or knowledge* which he has been employed by his principal to collect or discover, *or which he has otherwise acquired* , for the use of his principal, then again if he turns it to his own use, so as to make a profit by means of it for himself, *he is accountable ... for such information or knowledge is the property of his principal, just as much as an invention is* . ... [Italics in original; underlining added.]

71 Thus, in *MacMillan Bloedel Ltd.* , the retention of the profits by the fiduciary would have deprived the corporation of its right to the profits. The deprivation is represented by the monies obtained by the fiduciary as a result of infringing the rights of the plaintiff. In order for there not to have been deprivation and unjust enrichment in circumstances otherwise similar to *MacMillan Bloedel Ltd.* , the self-dealing could not have resulted in any secret profits — if a remedy were awarded in a case without profit, thus no enrichment nor deprivation, McLachlin J. could well point to the case for support. Given that there *was* profit in *MacMillan Bloedel Ltd.* , however, there was unjust enrichment which justified the order of a constructive trust, whether or not the court explicitly relied upon unjust enrichment.

72 In summary, McLachlin J. fails to refer to a single Canadian case where a constructive trust was ordered despite the absence of unjust enrichment. Given this conclusion and given that recent cases of this Court unambiguously foreclose the possibility of ordering a constructive trust in the absence of unjust enrichment, in my view McLachlin J. is in error in concluding that a constructive trust may be ordered in the absence of unjust enrichment.

73 Aside from Canadian case law, McLachlin J. attempts to rely on various scholars and foreign case law as providing support for her conclusion. Because of the clear statement of the law recently set out by this Court, in my view the scholarly writings and foreign cases are only useful insofar as the policy they set out suggests that the law in Canada should be modified. I will therefore simply address the policy upon which McLachlin J. relies, rather than each case and each article she cites.

74 Simply put, McLachlin J., reasoning similarly to the majority below, concludes that to fail to permit the order of a constructive trust where there has been a breach of a fiduciary duty, but no unjust enrichment, would inadequately safeguard the integrity of fiduciary relationships. She says at para. 33 that ordering a constructive trust simply on the basis of "good conscience",

> addresses not only fairness between the parties before the court, but the larger public concern of the courts to maintain the integrity of institutions like fiduciary relationships which the courts of equity supervised. ... The constructive trust imposed for breach of fiduciary relationship, thus serves not only to do the justice between the parties that good conscience requires, but to hold fiduciaries and people in positions of trust to the high standards of trust and probity that commercial and other social institutions require if they are to function effectively.

According to McLachlin J., then, deterrence of faithless fiduciaries requires the availability of constructive trust as a remedy even where there has been no unjust enrichment.

75 In my view, deterrence is not a factor which suggests modifying the law of Canada and permitting the order of a constructive trust even where there has been no unjust enrichment. As noted above, despite considerations of deterrence, it is true throughout the private law that remedies are typically unavailable in the absence of a loss. Courts have not, because of concern about protecting the integrity of these duties, held it to be necessary where a tort duty, or a contractual duty, has been breached to order remedies even where no loss resulted. I fail to see what distinguishes the role of fiduciary duties from the very important societal roles played by other legal duties which would justify their exceptional treatment with respect to remedy.

76 In any event, the unavailability of a constructive trust in cases where there is no unjust enrichment does not, in my opinion, have any significant effect on deterring unfaithful fiduciaries and protecting the integrity of fiduciary

relationships. First, if deterrence were deemed to be particularly important in a case, the plaintiff may seek and the trial judge may award exemplary damages; a constructive trust is not necessary to preserve the integrity of the relationship, even if this integrity were of particular concern in a given case. The fact that exemplary damages were not sought in the present case should not compel this Court to order a constructive trust in their place. Second, even if a remedy were unavailable in the absence of unjust enrichment, which is not true given exemplary damages, deterrence is not precluded. Taking a case similar to the present appeal, while an unscrupulous fiduciary would know that he or she would not be compelled to give up the surreptitiously obtained property if there were no gains in value to the property, he or she must also reckon with the possibility that if there *were* gains in value, and therefore unjust enrichment, he or she *would* be compelled to pay damages or possibly give up the property. Thus, if the fiduciary were motivated to breach his or her duty because of the prospect of pecuniary gains, which would, I imagine, be the typical, if not the exclusive, motive for such a breach, not ordering a constructive trust where there have been no pecuniary gains does not affect deterrence. I therefore disagree with McLachlin J. that deterrence suggests that a constructive trust should be available even where there is no unjust enrichment.

77 As is clear, I cannot agree with McLachlin J. that a constructive trust could be ordered, and indeed should have been ordered, in the present case even if there was no unjust enrichment. In order to decide whether such a remedy could be ordered, in my view, it must be decided whether there was unjust enrichment in the present case.

Was There Unjust Enrichment?

78 In my opinion, there was no enrichment and therefore no unjust enrichment in the present case. It is first of all plain that there were no pecuniary advantages accruing to the appellants from the purchase of the property. The trial judge stated (at p. 68):

> I now consider the facts of the case at bar. The nature of the duty and of the breach have already been discussed. At an interlocutory stage, the plaintiff abandoned any claim for damages. *This step involved no sacrifice because the plaintiff could not have proved any* . [Emphasis added.]

Any enrichment from the purchase of the property was not pecuniary, which would suggest that there has in fact been no enrichment and therefore no unjust enrichment.

79 It could, perhaps, be argued that if the property were unique or otherwise difficult to value, the defendant's pecuniary gains may not represent the enrichment of the defendant or the deprivation of the plaintiff. Analogizing to the award of specific performance in contract, where property that is the subject of a contract is unique or otherwise difficult to value, and the contract is breached, it may be held that monetary damages are inadequate and thus a remedy of specific performance must be ordered to compensate the plaintiff adequately. In such cases, pecuniary damages may not represent the loss to the plaintiff or the gain to the defendant from the breach. Thus, perhaps, an enrichment could be found in the absence of a change in market price if the property were unique or otherwise difficult to value.

80 Whether or not such considerations could be relevant to a finding of an enrichment, the property in question was not found to be unique or otherwise difficult to value in a manner relevant to the remedy. The trial judge noted that the respondent had asserted that the property in question had special value to him given its tenant, a bank, and the significance of being a landlord to a bank in the Greek community. The trial judge (at p. 69) held that such a factor should not be taken into account any more than personal attachment in an eminent domain case. In other words, while there may have been personal motivation for the purchase, this was not relevant to an assessment of the value of the property. This indicates, in my view, that the trial judge did not view the property to be unique in a manner meaningful to the remedial analysis. Such a conclusion is plain in the trial judge's analysis of *Lee v. Chow* (1990), 12 R.P.R. (2d) 217 (Ont. H.C.) . In *Lee* , a constructive trust was declared in a property that had been purchased surreptitiously by an agent in a situation similar to the present case. The trial judge in the instant appeal distinguished *Lee* in the following way (at p. 70):

> [The circumstances in *Lee*] included the following: a degree of dependence by the plaintiff which, in my view, is lacking in the case at bar; that it was a residential property meeting the specific requirements of the plaintiff, *rather than a commercial property having value only as an investment* ; and that it appeared probable that the acquisition price represented a bargain, while the property at issue in the case at bar did not. [Emphasis added.]

In *Lee* there were pecuniary gains, thus an enrichment, and the property had unique qualities which helped justify a constructive trust. In the present case there were no pecuniary gains, and the trial judge did not find any meaningful non-pecuniary advantages associated with the property — the property had value "only as an investment". In my view, given the absence of both pecuniary and non-pecuniary advantages from the property, there was no enrichment and therefore no unjust enrichment.

81 In the absence of unjust enrichment, in my view the trial judge was correct not to order the remedy sought, a constructive trust. The trial judge stated (at p. 69):

> A constructive trust was deemed appropriate in *Lac Minerals, supra* , because damages were deemed to be unsatisfactory. It would be anomalous to declare a constructive trust, in effect, because a remedy in damages is unsatisfactory, the plaintiff having suffered none.

The trial judge, in the absence of pecuniary damages which might have indicated unjust enrichment, declined to order a constructive trust. Neither the majority of the Court of Appeal nor McLachlin J. raise an error in principle in the trial judge's reasons; indeed, in my view they err in concluding that a constructive trust is available in the present case. Even if the trial judge ignored factors such as the moral quality of the defendants' acts and deterrence, which he did not, and even if this could be construed as an error in principle, the factors to be considered in ordering a constructive trust only become relevant at the second stage of the inquiry when it is decided what remedy is appropriate. Unless unjust enrichment is made out at the first stage of the inquiry, there is no need to consider the factors relevant to ordering a constructive trust. The majority of the Court of Appeal erred in interfering with the trial judge's discretion and in deciding that a constructive trust may be ordered in the absence of unjust enrichment.

Conclusion

82 Since the trial judge did not err in not ordering a constructive trust, but rather the majority of the Court of Appeal did in ordering one, I would allow the appeal, set aside the judgment of the Court of Appeal and reinstate the judgment of the trial judge. In the circumstances, I would not award costs to the appellants either here or in the Court of Appeal.

Appeal dismissed.

Pourvoi rejeté.

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34

1995 CarswellOnt 318
Ontario Court of Justice (General Division)

Canada (Attorney General) v. Confederation Life Insurance Co.

1995 CarswellOnt 318, 1995 C.E.B. & P.G.R. 8227 (headnote only), [1995] O.J. No. 1959, 24 O.R. (3d) 717, 31 C.C.L.I. (2d) 77, 33 C.B.R. (3d) 161, 56 A.C.W.S. (3d) 509, 8 C.C.P.B. 1, 8 E.T.R. (2d) 72

Re CONFEDERATION LIFE INSURANCE COMPANY; AND Re Insurance Companies Act, S.C. 1991, as amended; AND Re Winding-up Act, R.S.C. 1985, c. W-11, as amended

ATTORNEY GENERAL OF CANADA v. CONFEDERATION LIFE INSURANCE COMPANY

R.A. Blair J.

Heard: March 3, 7, 8, 20, 21, 27, 28 and 31 and April 5, 6 and 13, 1995
Judgment: July 4, 1995
Docket: Doc. RE 4315/94

Counsel: *Benjamin Zarnett, Andrea W. Rowe* and *Michele Altaras*, for Peat Marwick Thorne Inc., agent of Superintendent of Financial Institutions, provisional liquidator of Confederation Life Insurance Company.
Mark Zigler, Susan Rowland and *Cynthia Weekes*, appointed as representative counsel to represent interests of retirees of Confederation Life Insurance Company.
Donald C. Matheson, Q.C., Martha Milczynski and *Clifton Prophet*, appointed as representative counsel to represent interests of Supplementary Pensioners "In Pay"; and appointed as representative counsel to represent interests of Messrs. Rhind and Burns in respect of their claims for payment from Confederation Life Insurance Companies Deferred Compensation Plan.
Ronald Robertson, Q.C., Michael MacNaughton and *Edmond Lamek*, appointed as representative counsel to represent interests of Supplementary Pensioners "Not In Pay".
J.H. Grout and *Aida Van Wees*, appointed as representative counsel to represent interests of all policyholders and claimants of Confederation Life Insurance Company other than those persons described above.
Charles Scott and *David Roney*, for Canadian Life and Health Insurance Compensation Corporation.
Shaun Devlin and *Peggy McCallum*, for Superintendent of Pensions.
John Varley and *M. Jasmine Sweatman*, for Deloitte & Touche which was appointed administrator of Confederation Life Insurance Company Pension Plan for Canadian Salaried Employees by Superintendent of Pensions.
Hart Schwartz, for intervenor, Attorney General of Ontario.
R. Stephen Paddon, Q.C. and *Russell Laishley*, for Prost Investments Limited, Grant Forest Industries Corporation, Domco Food Services Ltd., Sullivan Entertainment, The Miller McAsphalt Corp. and CCL Industries Inc., policyholders.
Robb Heintzman, for Price Waterhouse Limited, liquidator for Confederation Trust Company.
Lawrence Ritchie, for Avenor Inc., Coopérative fédérée du Québec, Avenor Maritimes Inc., Bombardier Inc., ITT Industries of Canada Limited and AlliedSignal Canada Inc., policyholders.
Jeff Carhart, for Association of Confederation Life Contractholders, Inc.
Dana Fuller and *Derrick Tay*, for Fidelity Management Trust Company, policyholder.
Ian Morris, for Daniel Wiseblott, former employee of Confederation Life Insurance Company.

Subject: Corporate and Commercial; Insolvency; Estates and Trusts; Insurance

Headnote

Corporations --- Winding-up — Under Dominion Act — Claims of creditors

Corporations — Winding-up — Priorities — Employees of life insurance company ranking behind policyholders as ordinary unsecured creditors — Employees not qualifying as "policyholders" under s. 161(1)(c) of Winding-up Act and failing to establish facts that would support claim of trust — Winding-up Act, R.S.C. 1985, c. W-11, s. 161(1)(c).

A life insurance company was ordered to be wound up. The company had a contractual arrangement with its employees as part of their remuneration package. Under the arrangement, they would be entitled to long-term medical, dental and life insurance coverage after their retirement. The company had also set up a supplementary retirement income arrangement with its senior officers, the purpose of which was to "top up" the benefits provided under the company's registered pension plan for officers and employees.

One of the issues in the winding up process was the priority to the company's remaining assets between the employees and insurance policyholders. Since only "policyholders" are entitled to priority under the distribution provisions of the *Winding-up Act*, the employee claimants could only receive effective protection in the winding-up proceedings if they could show that their claims were in the nature of trust claims or if they could show themselves to be in the category of policyholders who had priority.

Held:

The policyholders had priority.

Under s. 161(1)(*c*) of the *Winding-up Act*, the claims of "policyholders" of the company rank in priority after the costs of the liquidation and preferred claim given to employees for three months' wages, but ahead of the priority provided in s. 161(2) for ordinary or general creditors. The only reason the claimants could argue that they were "policyholders" under the Act was because the liquidation of the company was a liquidation of an insurance company. Parliament could not have intended to treat employees differently with respect to priority on liquidation simply because of the nature of their employer's business. Therefore, the claimants were not "policyholders" as that term is used in s. 161(1)(*c*).

None of the claimants was successful in showing the existence of an express trust with respect to their benefits. The trust claims failed because certainty of intention to create a trust and certainty of subject-matter were not shown. No funds or assets were set aside or designated to fund any of the claimants retirement benefits arrangements.

Insufficient evidence was adduced to support the claimants' suggestion that constructive trusts should be declared. There was no indication that there was fiduciary relationship between the company and the claimants with respect to the retirement benefits arrangements. The evidence did not show a mutual understanding that the benefits would be pre-funded or secured, and there was nothing upon which to base a finding that the claimants had any reasonable expectation that the company had undertaken to subordinate its own interests, and those of its policyholders, to those of the claimants with respect to the benefits. Therefore, since there was no fiduciary relationship in this regard, no constructive trust could be imposed as a remedy for breach of the obligations arising out of such a relationship.

No constructive trust could be imposed on the basis of a finding of unjust enrichment. While the company benefitted from the services of its former employees, and they were going to suffer from the collapse of the company, the deprivation of the claimants was not related to the company's enrichment. The deprivation of the claimants related to the company's collapse. Therefore, there was not an enrichment and corresponding deprivation in these circumstances sufficient to found a claim of unjust enrichment.

Even if this was not true, there were several juristic reasons for the benefit or enrichment received by the company. First, given the contractual/employment relationship between the parties, the contract constituted a juristic reason for deprivation. A second reason for the enrichment was the existence of the winding-up proceedings. The scheme under the Act that provides for priority to policyholders over other creditors is a juristic reason for the enrichment. Finally, the fact of the insolvency nature of the proceedings represented a juristic reason for the enrichment. In such situations, it is not unjust for certain groups to be held to the contractual/employment arrangements that have governed their relationship prior to the insolvency/winding-up proceedings.

Even if unjust enrichment were found to exist, the imposition of a constructive trust would not be an appropriate remedy in the circumstances.

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s. 2 "policy"

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s. 1 "pension benefit"

s. 1 "pension plan"

s. 1 "pension plan" (*b*)

s. 3

s. 6

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s. 55(1)

s. 57

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s. 72

s. 159 "policy"

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s. 161(1)(*a*) [am. S.C. 1991, c. 47, s. 749(1)]

s. 161(1)(*b*) [am. S.C. 1991, c. 47, s. 749(2)]

s. 161(1)(*c*) [am. R.S.C. 1985, c. 18 (3rd Supp.), s. 44; am. R.S.C. 1985, c. 21 (3rd Supp.), s. 55(1); am. S.C. 1991, c. 47, s. 749(2)]

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Application by provisional liquidator for advice and directions regarding priorities between policyholders and former employees of insurance company.

***R.A. Blair J.*:**

Part A: Overview

1 "Confederation Life" is a venerable Canadian company. Known fondly in the industry for years as "Confed", it is one of the country's oldest and, until recently in any event, it was one of its most solid and most respected financial institutions. Fatally afflicted by the "real estate boom" disease of the 1980's, however, it has fallen into financial difficulties. A Court Order has directed that Confederation Life Insurance Company be wound up and liquidated.

2 The failure of such a financial institution invariably causes great hardship to certain segments of society. Innocent people suffer. Their financial plans and expectations are shattered. They must compete, in priority contests, for the scarcity of corporate assets which, by the very nature of the circumstances, are insufficient to satisfy all claims.

3 Such is the case here.

4 In this matter — at least in the proceedings before me — those affected are the Confederation Life policyholders, on the one hand (the widows, widowers and other investors who depend upon the reliability of the Company's life policies and annuities for their continued financial well-being) and the retired Confederation Life employees and supplementary retirement income beneficiaries, on the other hand (those who depend upon the benefits arising from their long-term employment relationship with the Company for their continued financial well-being). There is also an issue to be determined regarding deferred income arrangements involving the two most senior officers of the Company.

5 Confederation Life had a contractual arrangement with its employees, as part of their overall remuneration package, that they would be entitled to long-term medical, dental and life insurance coverage after their retirement. I am told that there are approximately 700 retired employees who fall into this category. Many have been retired for many years, are elderly, and depend upon the continuation of these benefits for their livelihood.

6 The Company also had a supplementary retirement income arrangement with its senior officers. The purpose of this arrangement was to "top up" the benefits provided under Confederation Life's registered pension plan for officers and employees to a level more consistent with the remuneration level of the senior officers. This was necessary because of limits imposed by Revenue Canada upon the level of pension benefits that can be provided through registered plans. There are 31 retired senior officers who claim to be entitled to such benefits; some of them were already receiving the supplementary retirement income benefit at the time of the liquidation Order, and some were not. There is no doubt that without the receipt of such payments, the affected former senior officers, too, will experience financial hardship.

7 Messrs. J.A. Rhind and P.D. Burns are the former Chairman and President of Confederation Life, respectively. In the early 1980's, when it was still permissible to do so, they had agreed to defer a portion of the income they had earned pursuant to what were known as "deferred compensation plans". Under such a plan, in exchange for deferring payment of a portion of their compensation to be earned in a given year, the employee was able to defer the tax on such amounts to a later taxation year (when, presumably, they would be taxed at a lower rate of taxation). Messrs. Rhind and Burns did so. The amounts accruing to their credit, as at December 31, 1993, totalled $1,185,780 — $707,143 to the credit of Mr. Rhind, and $478,637 to the credit of Mr. Burns. They now claim to be entitled to recover those monies from Confederation Life.

8 In these Reasons, I will refer to the retired employees, as a group, as "the Retirees"; to the senior officers claiming a supplementary retirement income benefit, whether in pay or not in pay, as the "Supplementary Pensioners"; and to

Messrs. Rhind and Burns, together, as "the Deferred Compensation Claimants". They are defined with more detail, and as classes of persons with potential claims in the liquidation and winding-up, in an order of Mr. Justice Houlden dated January 13, 1995 and attached as Sched. "B" to these Reasons [at p. 243].

9 I will refer to the three groups en masse, from time to time, as "the Claimants". Similarly, the three groups of benefits mentioned in the preceeding paragraphs will be referred to as "the Employee Benefits".

10 Since there is an issue to be determined as to whether the arrangements, which provide the senior officers with supplementary retirement income, constitute a "pension plan" or something else, such as a "retiring allowance", I intend to refer to these arrangements in these Reasons as the "supplementary retirement income arrangements". I recognize that there is a creature of the *Income Tax Act* (Canada) with a similar designation, known as an "SRIA" (a "Supplementary Retirement Income Arrangement"). By using the phrase "supplementary retirement income arrangements" I do not mean to ascribe to the arrangements here in question the meaning of the capitalized technical term of art in income tax parlance. I simply use it as the most convenient generic way in which to describe the supplementary retirement income benefits in a neutral fashion, for purposes of these proceedings.

11 There is little doubt that the Claimants have a contractual right to the recovery of the Group Benefits, the supplementary retirement income benefit, and the deferred compensation payments in question. I so hold at the outset. Such contractual entitlement, however, is not what is at issue here, in reality. As is the case in most financial collapses, Confederation Life has insufficient general assets to meet its obligations in full. It cannot provide the benefits and payments to which the Claimants are entitled and, at the same time, honour its other obligations, particularly those of the Company to its policyholders.

12 "Policyholders" are entitled to priority under the distribution provisions of the *Winding-up Act*. Consequently, notwithstanding their contractual entitlement to receive the benefits and payments claimed, the Claimants can only receive effective protection in the winding-up proceedings if their claims are in the nature of trust claims (express, statutory or constructive) — as they assert they are — or if they can place themselves amongst the category of Confederation Life "policyholders" who have priority — as they assert they can.

Part B Directions Sought And Issues

A. Directions Sought

13 Hence these proceedings.

14 The original Court Order came on August 15, 1994, and was made by the Honourable Mr. Justice Houlden pursuant to the provisions of the *Winding-up Act*, R.S.C. 1985, c. W-11, as amended. The winding-up is effective as of August 12, 1995. The Superintendent of Financial Institutions was appointed the Provisional Liquidator of the Company. It, in turn, appointed Peat Marwick Thorne Inc. as its agent to assist in the administration of the liquidation of the estate of Confederation Life.

15 In these proceedings, the Provisional Liquidator, through its agent, moves for directions in view of the dilemma arising from the foregoing circumstances. It seeks advice and direction regarding the following questions:

(a) Whether all or any of the Retirees, the Supplementary Pensioners In Pay, the Supplementary Pensioners Not in Pay, and the Deferred Compensation Claimants, as classes of persons, have claims against the estate of Confederation Life; and,

(b) If all or any of those classes of persons have a claim or claims against the estate of Confederation Life, does such claim or claims constitute:

(i) a trust claim?; or

(ii) a claim under a policy in respect of which priority is accorded to a policyholder by the provisions of s.161(1)(c) of the *Winding-Up Act*?

16 By Orders of Mr. Justice Houlden dated January 13 and February 8, 1995, representative counsel were appointed to represent each of the above classes.

B. The Issues

17 While question (b) above sets out the ultimate issues to be determined — are there "trust" claims and/or claims as "policyholders"? — there are a number of individual issues which must be addressed in making those determinations. They are varied and complex. For ease of reference, I set out the issues to be considered by the class of Claimant. They are as follows:

With Respect to the Retirees:

a) Are the assets of Confederation Life subject to an express trust in respect of the amount required to satisfy all benefit liabilities under the Group Benefit Plans?

b) Alternatively, are the assets of Confederation Life subject to a constructive trust in respect of the amount required to satisfy all benefit liabilities under the Group Benefit Plans arising as a result of either,

(i) a breach of fiduciary duty; or,

(ii) an unjust enrichment?

c) Are the Retirees "policyholders", as that term is utilized in s.161(1)(c) of the *Winding-Up Act*, *supra*, and thus entitled to share *pari passu* in the priority accorded to policyholders by that section?

d) Should the Court exercise its discretion under s.33 of the *Winding-Up Act*, *supra*, to require the Provisional Liquidator to keep the Group Benefits in place or to compel the Provisional Liquidator to take legal action on behalf of the Retirees against certain alleged, but not particularly well specified wrongdoers?

With Respect to the Supplementary Pensioners:

(a) Is there a distinction to be drawn in the treatment of the Supplementary Pensioners "In Pay" and the Supplementary Pensioners "Not in Pay"?

(b) Are the assets of Confederation Life subject to an express trust in respect of the amount required to satisfy all benefit liabilities under the supplementary retirement income arrangements?

(c) Alternatively, are the assets of Confederation Life subject to a constructive trust in respect of the amount required to satisfy all benefit liabilities under the supplementary retirement income arrangements, arising as a result of either,

(i) a breach of fiduciary duty; or,

(ii) an unjust enrichment?

(d) Are the Supplementary Pensioners In Pay and Not In Pay entitled to the priority accorded to "policyholders" within the meaning of s.161(1)(c) of the *Winding-Up Act*, *supra*?

(e) Are the supplementary retirement income arrangements a "pension plan" to which the *Pension Benefits Act*, R.S.O. 1990, c. P-8 applies?

(f) If the supplementary retirement income arrangements are a "pension plan", does R.R.O. 1990, Reg.909, s.47(3)6, as amended to October 28, 1994 [by O. Reg. 665/94] apply?

(g) If the *Pension Benefits Act*, *supra*, applies to the supplementary retirement income arrangements, is Confederation Life deemed, pursuant to s.57(3) of the *Act*, to hold in trust an amount equal to the due but unpaid contributions required under the legislation and regulations?

(h) If the *Pension Benefits Act*, *supra*, applies to the supplementary retirement income arrangements, are the assets of Confederation Life subject to a lien and charge, pursuant to s. 57(5) of the *Act*, in an amount equal to the due but unpaid contributions required by the legislation and regulations?

(i) Does the lien and charge created by s.57(5) of the *Pension Benefits Act*, *supra*, constitute a secured claim against the estate of Confederation Life?

(j) If the supplementary retirement income arrangements are a "pension plan" subject to the *Pension Benefits Act*, *supra*, does the operation of the *Act* conflict with the *Winding-Up Act*, *supra*, thereby rendering the operation of the *Pension Benefits Act*, *supra*, unconstitutional as a result of the application of the doctrine of paramountcy?

(k) What is the test to be applied for determining whether federal legislation is paramount?

With Respect to the Deferred Compensation Claimants:

(a) Are the assets of Confederation Life subject to an express trust in respect of the contributions from salary made by the Deferred Compensation Claimants, together with interest, for the full amount of the balances standing to the credit of their Accounts?

(b) Are the assets of Confederation Life subject to a constructive trust in respect of the contributions from salary made by the Deferred Compensation Claimants, together with interest, for the full amount of the balances standing to the credit of their Accounts, arising as a result of either,

(i) a breach of fiduciary duty; or

(ii) an unjust enrichment?

(c) Are the Deferred Compensation Claimants entitled to the priority accorded to "policyholders" within the meaning of s.161(1)(c) of the *Winding-Up Act*, *supra*?

18 Thus, each of the groups of Claimants is asserting a claim based upon an express trust, upon the imposition of a constructive trust, and upon an entitlement as a "policyholder". The Retirees raise an additional argument based upon the Court's discretion to impose duties upon a liquidator under s.33 of the *Winding-up Act*. Finally, there are an additional series of "pension" or *Pension Benefits Act* issues and a constitutional issue which relates to the Supplementary Pensioners' claims.

19 Before beginning the trek through this myriad of issues, I turn to a fuller outline of the factual circumstances surrounding the Winding-Up and the Claims.

Part C: Facts

A. Confederation Life's "Benefit" Programs

20 Confederation Life has provided employee benefits as part of its employment package since 1924. The extent and subject matter of the benefits has evolved over the years. As at the date of the winding-up, however, the benefits consisted primarily of the following:

21 (a) Group Life Insurance;

22 (b) Group Accidental Death and Dismemberment Insurance;

23 (c) Major Medical benefits;

24 (d) Dental benefits;

25 (e) Registered Pension Plan benefits;

26 (f) Supplementary Retirement Income benefits; and

27 (g) Deferred Compensation Plan benefits.

28 All except the registered pension plan benefits are at issue in these proceedings. I shall refer to that Plan in these Reasons as the "Registered Pension Plan". Similarly, the Group Life and Accidental Death and Dismemberment Insurance and the Major Medical and Dental benefits will be referred to in these Reasons, collectively, as "the Group Benefits".

B. The Retirees

29 The Group Benefits were provided by Confederation Life to its employees, both while they were actively employed and upon their retirement, as part of each employee's overall compensation package. As stated in the Confederation Life Employee Handbook (at p.2) [emphasis added]:

> Compensation, in total, consists of salary, group life, health, dental and pension benefits, vacations and many other fringe benefits provided for staff members. These items require a direct significant contribution from the Company on behalf of each employee. *Thus total compensation is a composite, of which salary is the most visible and significant item*.
>
> . . . . .
>
> Our approach to overall compensation is to be in line with general community levels in the areas where we operate, and to provide a fair return for the contribution each staff member makes to the Company's operating success.

30 While at one point in their history the Group Benefit Plans required employee contribution, at the date of the Winding-Up Order they were paid in full by Confederation Life.

31 The source of authority for the current Group Benefit Plans is to be found in a by-law enacted by the Board of Directors of Confederation Life on April 20, 1955. The By-law provided:

> (a) that a Board of Trustees be appointed to administer the group insurance plans on behalf of Confederation Life, as employer (the "Trustees");
>
> (b) that the benefits to be provided under the group contracts, and the rules and regulations pertaining thereto, would be determined by Confederation Life from time to time; and,
>
> (c) that the Board of Directors of Confederation Life could at any time direct the payment of premiums respecting any or all group insurance plans be discontinued and employees no longer be entitled to any related benefits.

32 That foundation for the Group Benefit Plans has not changed.

33 No formal trust agreement was ever entered into between Confederation Life, as employer, and the Trustees of the Plans. In April, 1993, however, the Board of Directors approved a document entitled "Guidelines for Canadian Group

Benefit Plan Trustees". These Guidelines distinguished between the duties of the Trustees in relation to the pension plans and their duties in relation to the Group Benefit Plans. They provided that the Trustees should [emphasis added]:

> (1) with respect to *the pension plans* they are responsible for:
>
> (a) ensure that the plans are funded in a manner that will enable them to meet all their obligations; ...
>
> (c) administer the plans in accordance with the plan documents established by Confederation Life in a manner that provides equity and consistency of treatment for all participants; and
>
> (2) with respect to *the other group benefit plans* they are responsible for:
>
> (a) administer the plans in accordance with the contracts established by Confederation Life in a manner that provides equity and consistency of treatment for all participants; ...

The Guidelines, I observe, place no obligation upon the Trustees to ensure that the Group Benefit Plans were funded, whereas such an obligation is expressly stated with respect to pension plans. These Guidelines were not distributed to the employees of Confederation Life.

34 What *was* distributed to the employees of Confederation Life were a series of booklets describing the employment benefits that the Company offered (the "Booklets"). The Booklets were later replaced with a handbook entitled "Your Confed Handbook" (the "Handbook"). Prior to 1983, the benefits for retired employees were described in the Booklets. Thereafter, upon retirement, retired employees were provided with a pamphlet entitled "Benefits for Retired Employees of Confederation Life in Canada" summarizing the benefits provided to retired employees (the "Retirement Pamphlets"). In each of the three documents, a statement appeared advising employees that the document merely outlined or summarized the benefits and provisions of the group plan but,

> does not create or confer any contractual or other rights. All rights with respect to the benefits of a member will be governed by the Group Policy.

35 Although this statement varied slightly in each of the Booklets, Handbooks and Retirement Pamphlets, the substance of the statement in each is consistent.

36 The Benefits, and the documents reflecting them, were amended from time to time. When this occurred — at least in later years — employees and retired employees were notified and replacement pages were circulated. In October 1991 the Handbook was amended by providing that employee benefit coverage could cease on the "Termination of the Contract or coverage under the Division or Class to which [the employee] belong[ed]." This same warning did not appear in the Retirement Pamphlets, however, until the publication of the last pamphlet in May 1993. That Pamphlet begins with a section bearing the word "Important" which states [emphasis added]:

> This booklet contains information concerning your group coverage and should be kept in a safe place. *It supersedes and replaces all previous communication material.*
>
> *Confederation Life's services with respect to Major Medical and Dental Benefits are provided on an administrative basis only. Such benefits are not insured by Confederation Life. All other benefits are underwritten and insured by Confederation Life.*
>
> This booklet summarizes the benefits and provisions of your Group Plan. *It does not constitute the Group Contracts and is not a contract of coverage, nor does it create or confer any contractual or other rights.* Every effort has been made to insure that the information is accurate. However, if there is any question as to interpretation, all rights with respect to a covered person will be governed solely by the Group Contracts issued by Confederation Life Insurance Company.

37 As the foregoing notice indicates, there is a difference in the manner in which the Group Life benefits (including Accidental Death and Dismemberment benefits) and the other benefits are provided. The Major Medical and Dental benefits are not insured. The Group Life benefits are. These are the arrangements that were in effect at the time of the winding-up. They superseded and replaced all earlier communications.

38 The Group Life benefits are provided through group insurance policies issued by Confederation Life, as insurer, to the Trustees, as policyholders ("the Life Policies"). The Life Policies are experience-rated policies with the premiums determined annually based upon the claims experience of the employees of Confederation Life covered thereby. Each of the Life Policies is renewable annually, on March 31st, upon payment of the premium due, and expires annually.

39 Major Medical and Dental benefits have been provided to employees and retirees on a self-insured basis since the 1980's, pursuant to a series of plan documents (the "Group Plans") and administrative services only ("ASO") contracts. An ASO contract is a contract by which an employer provides benefits for its employees. The employer is responsible for the cost of the benefit payments but an insurance company is retained to provide administrative services such as processing claims and sending out cheques and receives a fee for providing those services. In these arrangements, the insurance company does not agree to indemnify the employer for claims made.

40 Under the ASO contracts at issue in this action, Confederation Life, as insurer, contracted with the Trustees to provide administrative services only. Confederation Life, as employer, is responsible for the cost of the benefit payments. The ASO contracts were not distributed to the Retirees.

41 Like the Life Policies, each of the Group Plans and ASO contracts in question was for a term of one year, renewable annually, on March 31st, for a further term of one year upon payment of the first premium due for the new policy year. All of the existing coverages for the Group Benefits have, therefore, technically speaking, ceased. However, the Provisional Liquidator, through its agent, has continued to make premium payments since the date of the Winding-Up Order with respect to the Life Policies and Group Plans which were in place on August 12, 1994, pending the decision of the Court.

42 It is clear from the materials filed, and from the evidence, that none of the Group Benefit Plans were protected by any form of pre-funding mechanism or secured by any form of segregated trust fund or other assets. The cost of the Group Benefits was expensed annually as the related insurance premiums and medical/dental liabilities were incurred.

43 It is, of course, the lack of any such protection or security, which would enable the Group Benefits to be continued, notwithstanding the winding-up of Confederation Life, that lies at the heart of the Retirees' position on this Motion.

C. Supplementary Pensioners "In Pay" and Supplementary Pensioners "Not In Pay"

44 Since 1975 Confederation Life has provided supplementary retirement income arrangements for senior officers to supplement the pension benefits received under the Company's Registered Pension Plan. The necessity for such arrangements arose because of limits contained in the *Income Tax Act* (Canada) on the amount of pension income which could be paid from a registered pension plan (the "Revenue Canada limits"). The purpose of the supplementary retirement income arrangements was to ensure that senior officers received the full retirement benefit to which their income level and years of service would otherwise have entitled them but for the Revenue Canada limits.

45 While initially confined to a small group of officers, by the time of the Winding-Up Order of August 15, 1995, the supplementary pension arrangements extended to 31 senior officers of the Company. Of these, 11 were receiving payments at the time of the Order and 20 were not.

46 Confederation Life's supplementary retirement income arrangements were established in accordance with two resolutions of the Company's Board of Directors. In the first resolution, dated June 21, 1972, the Board approved in principle the concept of providing "a supplementary pension" to those officers whose pensions would otherwise be limited

by the Revenue Canada limits; management was asked to investigate the method of handling the matter, possibly by way of employment agreement. In the second resolution, dated July 16, 1975, the Board authorized,

> that on retirement there be provided a retiring allowance consistent with the service and contribution by such members to the Company as authorized by the Board of Directors.

47 The supplementary retirement income arrangements were not implemented through the creation of a formal plan document. Instead, Confederation Life advised the senior officers of their entitlement to this benefit by sending them a form letter. All of these letters cannot be found, but I am told that letters in the materials which are dated in April 1983 (the "April 1983 Letters") are reasonable samples of what was sent and received — at least until June 1993. While the form of the various April 1983 Letters varies slightly, their substance remains the same. The following statement appears in some fashion in each:

> In accordance with a resolution of the Board of Directors, the Company agrees to provide you in recognition of your valuable, loyal and long devoted service, a retiring allowance payable monthly commencing on the 28th day of the month following your actual retirement. The retiring allowance will be payable during your lifetime provided you are willing, consistent with your age and health, to make yourself available to the Company in a consulting capacity at reasonable times, and provided you agree to not engage in competing business without prior approval from the Company, nor to divulge or communicate confidential information of the Company.

48 The April 1983 Letters go on to describe the formula upon which the "retiring allowance" is based. They then conclude with this comment:

> In the unlikely event that your employment with the Company is terminated for cause, the retiring allowance is not vested to you and therefore not payable.

49 To indicate their concurrence with the supplementary retirement income arrangements, the senior officers were asked to return a signed copy of the letter.

50 The terms of the supplementary retirement income arrangements were later restated by way of a form letter dated June 9, 1993 (the "June 1993 Letter") sent by Mr. J.R. Cunningham to all eligible members. Mr. Cunningham was at all material times a senior officer of Confederation Life — the Vice President, Corporate and Human Resources. He was head of the Company's Human Resources department and secretary to the Human Resources and Compensation Committee of the Board of Directors, although he was not a member of the Board. He provided evidence, by affidavit, on behalf of the Claimants.

51 Mr. Cunningham distributed copies of both the April 1983 Letters and the June 1993 Letter.

52 The June 1993 Letter states in part as follows:

> The purpose of this letter is to clarify and confirm your entitlement to the Senior Officers' Supplementary Pension Arrangement.
>
> In accordance with a resolution of the Board of Directors and in order to ensure that your post retirement income compares equitably to other employee members of the registered Pension Plan for Salaried Employees, when measured as a percentage of pre-retirement income, the Company agrees to provide you with a Supplementary Pension on your retirement. This supplement will be in addition to the pension benefit you will receive from the registered pension plan and recognizes that the amount of pension benefit which can be provided under the provisions of the registered Plan is limited by Revenue Canada regulations.
>
> . . . . .
>
> 1. (Sets out how the Supplementary Pension is to be paid)

Any Supplementary Pension payable under this arrangement will be paid in the same form and in the same manner as you elect for the pension income from the registered pension plan.

3. From time to time the Company may, on an ad hoc basis, increase the amount of pension being paid to retired members (or their beneficiaries) of the registered pension plan. In this event, the amount of the Supplementary Pension will be increased in a similar and consistent manner.

4. In the event of your death after retirement, the form of the Supplementary Pension amount continuing to your spouse or other beneficiary will be of the same form as that under the registered pension plan, with the same actuarial adjustment being applied if such is required under the registered plan.

7. If you should leave the Company prior to retirement, you shall be entitled to a deferred Supplementary Pension payment determined in the same manner as outlined in point 1 above. ... You should be aware, that in the event you leave the Company prior to retirement, the Supplementary Pension will only be provided as a deferred payment and it is not permissible to receive or transfer the lump sum actuarial equivalent of your pension benefits. Further, in the unlikely event that your employment with the Company is terminated for cause, the Supplementary Pension is not vested to you, and therefore not payable.

53 Administration of the supplementary retirement income arrangement was the responsibility of the Corporate Human Resources Department of Confederation Life, under the supervision of Mr.Cunningham. The Trustees had no responsibility for the supplementary retirement income arrangements, notwithstanding the "Guidelines" referred to earlier in these Reasons which envisage responsibility for both the Company's "pension plans" and the Group Benefit Plans being with the Trustees. Moreover, the liability for the supplementary retirement income benefit does not form part of the pension plan obligations under the Company's Registered Pension Plan. None of the Annual Reports of the Trustees for the years 1986, 1987, 1992, 1993, and 1994 refers to a supplementary retirement income arrangement.

54 The supplementary retirement income arrangements were not funded. At no time did Confederation Life set aside any specific funds or assets to support the liability to pay those benefits. Neither the April 1983 Letters nor the June 1993 Letter make reference to the creation of a trust or the segregation of assets to secure the supplementary retirement income arrangements.

55 There was an account — Account 2332G (later 20332) — created in the records of Confederation Life pertaining to the supplementary retirement income arrangements and reflecting activity in it. These were accounting entries only, however, and the account did not represent any assets of Confederation Life; nor was it an account in which assets were deposited or held. It was an account created to record the accruing actuarial liabilities attributable to the supplementary retirement income arrangements. When payments were made to the Supplementary Pensioners, they were made from the general funds of Confederation Life, not from any funds or assets in Account 2332G.

56 From 1990 forward, Confederation Life obtained annual actuarial valuations with respect to both the Registered Pension Plan and the supplementary retirement income arrangements from Towers Perrin, a firm of actuarial and compensation consultants. These Reports revealed that the market value of the assets of what the authors called the Supplementary Pension were nil and that the liability for it was increasing. The Towers Perrin Report dated June 27, 1991, stated "that there are no assets segregated in a fund for the purposes of securing the benefit obligations of the Program."

57 In late 1993, Mr. Cunningham requested Towers Perrin to prepare a report which focused upon providing security and funding for the payment of benefits promised under the supplementary retire ment income arrangements. According to the Towers Perrin Report dated November 8, 1993, several options were available to Confederation Life in order to secure its obligation to provide these benefits in the event it were unable or unwilling to make payments. These options included: obtaining a third-party guarantee, obtaining a surety bond, obtaining a bank letter of credit, or establishing a fully funded trust. The Report concluded:

There is no magic to any of these methods of providing security. Each of them will probably cost the company more than an unsecured promise.

58 The Report went on to discuss what it referred to as supplementary pension benefits:

These benefits are paid monthly to retirees through "payroll". Unlike the registered plan benefits that are well funded and secure against any calamity happening to Confederation Life, receipt of these benefits is dependent on the future financial health of the company. This is consistent with common practice in Canada. Less than 10% of companies have funded or otherwise secured these kinds of obligations.

59 Confederation Life did not implement any of the options recommended in the Towers Perrin Report, and the supplementary retirement income arrangements remained — as they had been at all times — unfunded.

60 The Liquidator has ceased making payments to the Supplementary Pensioners In Pay and has indicated that it will not make payments to those Not in Pay.

D. Deferred Compensation Claimants

61 In December 1981, Confederation Life established a senior management Deferred Compensation Plan to provide retirement benefits to certain designated senior executives. Mr. Rhind and Mr. Burns, the Chairman and President of the Company, respectively, were the only two persons ever designated as members of the Plan.

62 Deferred compensation plans are income tax mechanisms, designed to allow senior executives to defer entitlement to all or part of their employment income until after retirement, at which time its receipt would provide a source of post-retirement income that would be taxable at (presumably) lower marginal rates applicable in the years of retirement.

63 A deferred compensation plan, being the tax-driven instrument that it is, is a complicated and carefully chiselled instrument. It is carefully chiselled because, if not, it may unwittingly be caught in the tentacles of one or another of the myriad of different tax instruments which exist, and thus attract undesired tax consequences. In the case of Confederation Life's Deferred Compensation Plan, the tax deferral aspects of it were approved in an advance ruling by Revenue Canada, dated June 18, 1982.

64 The advance ruling obtained from Revenue Canada was based upon a specific series of representations which were made by Confederation Life and Messrs. Rhind and Burns. Those representations included the terms of the Deferred Compensation Plan referred to above. Both Confederation Life and Revenue Canada treated the Plan as a "retirement allowance" and expressly agreed that it was not an "employee benefit plan" or an "employee trust" within the meaning of s. 248 of the *Income Tax Act* (Canada).

65 The operation of the Plan is described in a plan document entitled "Senior Management Deferred Compensation Plan". It is in the form of an agreement between Confederation Life and Messrs. Rhind and Burns. In essence, the members are required to elect, on an annual basis, the amount of income earned in the year in question that they will not defer. This amount of their annual income they receive. The balance is deferred, but it is not put anywhere awaiting the member's retirement. It is, in fact, not paid, although the Company accrues a liability for its payment, with interest. A ledger account is set up on the Company books, in which the deferred amounts are recorded and interest is credited on the balance.

66 Upon retirement, all deferred amounts become payable as directed by the member or the member's beneficiary in an election.

67 The Deferred Compensation Plan is quite specific about these matters. It includes, for instance, the following terms:

Crediting of Portions of Deferred Amounts to Member's Accounts

> The Deferred Amount for a Period shall not be paid into the Plan by the Employer nor shall it be construed to be so paid.
>
> In respect of each Period, the Employer shall pay to a Member ... all amounts included in such Member's Aggregate Cash Remuneration for such Period until the aggregate of such payments is equal to the member's Non-Deferred Amount for such Period. The Employer shall not pay to the Member any other amounts included in such Member's Aggregate Cash Remuneration for the Period but will credit each of such other amounts, as at the date that but for the provisions of the Plan it would otherwise have become due, to such Member's Account.
>
> For greater certainty, such crediting is entirely a matter of internal bookkeeping of the Employer and the Employer shall be under no obligation to make any actual payments to the Plan.

68 As in the case of the Group Benefits and the supplementary retirement income arrangements, Confederation Life's Deferred Compensation Plan was not pre-funded or secured by any form of segregated assets. Indeed, the terms of the Plan do not refer to the establishment of a trust, or to the segregation of funds or assets. Similarly, as noted, they do not oblige Confederation Life to make actual payments to the Plan.

69 Mr. Rhind retired from employment with Confederation Life in April, 1985. He continued to act as a director of Confederation Life until November 14, 1994, however, and because of that he had not yet begun to receive payments under the Deferred Compensation Plan prior to the Liquidator's decision to withhold further payments. At the date of the Winding-Up Order, Mr. Burns had retired and was receiving equal monthly instalments as per his election. At the time of his retirement, he elected not to purchase an annuity.

70 As of December 31, 1993 the Account for Mr. Rhind showed a balance of $707,142.76 and the Account for Mr. Burns showed a balance of $478,637.

71 The Provisional Liquidator has stopped making payments to Mr. Burns under the Plan and has refused to make such payments to Mr. Rhind.

Part D: The Positions of the Parties

A. The Retirees

72 The Retirees submit that they are entitled, either by virtue of an express trust or by virtue of the imposition of a constructive trust to have a sufficient portion of the assets of Confederation Life segregated from the Company's general assets and set aside to fund the continued provision of the Group Benefits. They approach the constructive trust objective from two different directions: first, they submit that a fiduciary relationship exists between Confederation Life and its employees and retired employees in relation to the Group Benefits and that the imposition of a constructive trust is the appropriate remedy for the Company's breach of that fiduciary duty by failing to pre-fund and secure the Benefits; and secondly, they submit that the imposition of a constructive trust is the appropriate remedy to redress an unjust enrichment which Confederation Life has enjoyed at the expense of its employees in this regard.

73 The Retirees argue further, and in any event, that they are "policyholders" within the meaning of para. 161(1)(*c*) of the *Winding-up Act*, supra, and, accordingly, that they are entitled to share pari passu with other policyholders in the distribution of the assets of the Company upon the winding-up.

B. The Supplementary Pensioners

74 The Supplementary Pensioners also argue that the assets of Confederation Life are subject to an express trust in the amount required to fund all benefit liabilities under the supplementary retirement income arrangements. Alternatively, they assert the constructive trust argument, based upon the breach of a fiduciary duty and upon the notion of unjust

enrichment. They submit, as well, that they are "policyholders" within the meaning of para. 161(1)(*c*) of the *Winding-up Act*, supra.

75 These Claimants then raise a series of "pension plan" issues arising under the *Pension Benefits Act*, supra. They submit that Confederation Life's supplementary retirement income arrangements constitute a "pension plan" as defined in the Act, and that therefore there is a deemed statutory trust in the amount necessary to fund the arrangements and, in addition, a statutory lien and charge against the Company's assets for that amount: *Pension Benefits Act*, supra, subss. 57(3) and 57(5).

76 If the latter issues regarding a statutory trust, lien and charge are determined in favour of the Supplementary Pensioners, an issue arises as to whether the operation of the *Pension Benefits Act*, supra, is unconstitutional in these circumstances because of the doctrine of paramountcy.

C. The Deferred Compensation Claimants

77 The Deferred Compensation Claimants submit that the full amount of the balances outstanding in their accounts are protected by reason of an express trust, or, alternatively, by reason of a constructive trust based upon a breach of fiduciary obligation and upon the doctrine of unjust enrichment. They also argue that they are "policyholders", as contemplated by para. 161(1)(*c*) of the *Winding-up Act*, supra.

78 I will deal with each of these submissions separately.

Part E: Law and Analysis

79

I. The Claimants as "Policyholders" of Confederation Life

80 The Claimant groups each argue that they are "policyholders" within the meaning of para. 161(1)(*c*) of the *Winding-up Act*, supra, and therefore that they are entitled to share pari passu with other policyholders in the liquidation proceeds in accordance with the priority scheme of distribution set out in that provision. For the Retirees, this claim is premised upon the existence of an *indemnity-like* contract; for the Supplementary Pensioners and the Deferred Compensation Claimants, it is premised upon the existence of an *annuity-like* contract.

81 As these submissions raise issues that go to the heart of the purpose of winding-up proceedings, in general, and the scheme of priority distribution of assets, in particular — all in the context of a life insurance company insolvency — I will address them first even though they are not articulated first either in the questions as put forward by the Provisional Liquidator for directions or in the issues as I have earlier summarized them.

82 Under para. 161(1)(*c*) of the *Winding-up Act*, supra, claims of "policyholders" of the Company rank in priority after the costs of liquidation and a preferred claim given to employees for 3 months wages but ahead of the priority provided for in subs. 161(2) for the ordinary or general creditors. The priority scheme, as set out in s. 161, is as follows [emphasis added]:

> 161.(1) Subject to this Act, claims shall be paid in the following order of priority:
>
> (*a*) costs of liquidation and the mortgage insurance and special insurance portions of the expenses described in paragraph 686(1)(*a*) of the *Insurance Companies Act* that were incurred by the Superintendent in respect of the Company after March 31, 1986;
>
> (*b*) claims of preferred creditors, specified in section 72;
>
> (*c*) *claims of policyholders of the company ranking as follows*:

(i) if reinsurance is not effected as provided in section 162,

(A) *firstly*, any of the following claims:

(I) *in the case of policies of life insurance and policies of accident and sickness insurance, claims that have arisen under those policies of the company*, in accordance with the terms thereof, prior to the date of the filing of the statement of the liquidator in the Office of the Superintendent of Financial Institutions as provided in subsection 168(1), less any amount previously advanced by the company on the security of those policies, and claims of holders of policies of life insurance and policies of accident and sickness insurance to the value of those policies computed as provided in section 163, and

(II) in the case of policies of insurance other than policies of life insurance and policies of accident and sickness insurance, claims that have arisen under those policies of the company by reason of the occurrence of the event insured against, in accordance with the terms thereof, prior to the date of the filing of the statement of the liquidator in the Office of the Superintendent of Financial Institutions as provided in subsection 168(1), less any amount previously advanced by the company on the security of those policies, and

(B) secondly, in the case of policies of insurance other than policies of life insurance and policies of accident and sickness insurance, the claims of such policyholders to the value of those policies computed as provided in section 163 or, as the case may be, claims that have arisen under those policies of the company by reason of the cancellation of such policies, in accordance with the terms thereof, prior to the date of the filing of the statement of the liquidator in the Office of the Superintendent of Financial Institutions as provided in subsection 168(1), less any amount previously advanced by the company on the security of the policies, or

(ii) if reinsurance is effected ... (this part is not relevant to these proceedings)

. . . . .

(2) *Other creditors and policyholders of the company*, including policyholders claiming any minimum amount that a life company has agreed to pay under a policy ... are entitled to receive a dividend on their claims only if the assets are more than sufficient to pay the claims specified in subsection (1).

(i) The Retirees

83 In the case of the Retirees, the "policyholder" argument is based on the premise that the Group Benefits are provided by way of contracts of indemnity — and, thus, are policies of insurance — under which they are entitled to benefit and, accordingly, that they are entitled to rank as "policyholders" under subs.161(1) of the *Winding-up Act*, supra.

84 I accept, after some initial hesitation, that the Retirees' rights to Group Benefits flow from "policies of insurance" to that effect. Although it may appear implausible, at first appearance, that an employer who promises to provide such benefits becomes an "insurer" in this respect, an examination of the relevant legislative defining provisions seems to lead inexorably to that conclusion.

85 "Policy" of insurance is given a very broad meaning in insurance legislation, and "policy" is defined in s.159 of the *Winding-up Act*, supra, as including "policy" as defined in the *Insurance Companies Act*, S.C. 1991, c.47, as amended, s.2. There, the term "policy" is stipulated to mean:

any written contract of insurance ... whether contained in one or more documents ... and includes any annuity contract.

86 There is no definition of "contract of insurance" in the federal *Insurance Companies Act*, supra, but in Ontario, "insurance" is defined in s.1 of the *Insurance Act*, R.S.O. 1990, c.I.8, as amended, as follows:

> "insurance" means the undertaking by one person to indemnify another person against loss or liability from loss in respect of a certain risk or peril to which the object of the insurance may be exposed, or to pay a sum of money or other thing of value upon the happening of a certain event, and includes life insurance;

87 Since a "contract" under the *Insurance Act*, supra, simply means "a contract of insurance" and includes "a writing evidencing the contract", Confederation Life's promise to provide the Group Benefits, as evidenced by the Booklets, Handbook and Retirement Pamphlets, and by the Group Benefit Plan documents, would seem to amount to a "policy of insurance". It is evidenced in writing, albeit in one or more documents; and it constitutes "the undertaking by one person (Confederation Life) to indemnify another person (the Retiree) against loss or liability from loss in respect of a certain risk or peril to which the object of the insurance may be exposed (i.e., to the risk or peril of illness and the costs of dealing with it). Why, then, is it not a "written contract of insurance", as contemplated by the *Insurance Companies Act*, supra, and therefore a "policy", as contemplated by the *Winding-up Act*, supra? In my opinion, it is.

88 What is missing from the foregoing analysis, and from the specific definition of "insurance" in the *Insurance Act*, supra, is the concept of "premium", an essential characteristic of a contract of insurance — the consideration in exchange for which the benefit is provided. While consideration is necessary, it is well established, however, that it need not take the form of a cash payment: see *Prudential Insurance Co. v. Inland Revenue Commissioners*, [1904] 2 K.B. 658 at p. 663; *California Physicians' Service v. Garrison* (1946), 172 P. 2d 4 at pp. 17-18, adopted by Pennell J. in *Bendix Automotive Canada Ltd. v. U.A.W., Local 195*, [1971] 3 O.R. 263 (H.C.) at pp. 270-271. In the latter case, the Court held that an employer's obligation under a collective agreement to reimburse employees for what today would be called "extra billing" payments constituted "a contract of insurance" and that the consideration was to be found in the employees' own covenants in the collective agreement. Here, the consideration is found in the Retirees' former contributions of labour, skill and knowledge in exchange for which Confederation Life's compensation package as a whole had been offered.

89 Consequently, I am satisfied that the Retirees are the holders of "policies of insurance", for these purposes.

90 It is argued that there can be no insurance with respect to the Major Medical and Dental benefits because they are provided through the mechanism of "administrative services only" contracts. In this sort of arrangement the Company, as employer, "self-insures" and accepts the risk associated with providing the benefits; it is directly responsible for payment of all claims. The Company's role as insurer *in this respect* is purely administrative; it processes and deals with claims in exchange for an administrative fee. Such arrangements do not constitute insurance: see Norwood & Weir, *Norwood on Life Insurance in Canada*, 2nd ed. (Toronto: Carswell, 1993) at p. 142.

91 The Retirees Handbook itself seems to recognize the same distinction. On the first page, under a heading entitled "Important", the following is to be found [emphasis added]:

> Confederation Life's services with respect to Major Medical and Dental Benefits are provided on an administrative basis only. *Such benefits are not insured by Confederation Life*. All other benefits are underwritten and insured by Confederation Life.

92 To my mind, however, the distinction which needs to be made on these facts is the following. There is a difference between the nature of the relationship between Confederation Life, *as employer*, and its employees, and the nature of the relationship between Confederation Life, *as insurer*, and itself (i.e., the Trustees) as the holder of the ASO contracts. With regard to the latter, there is no contract of insurance. In relation to the former, however, in these circumstances, a contract of insurance exists.

93 Unfortunately for the Retirees, however, this result — while it takes them along the road they seek to travel — does not get them to the destination they seek to reach.

94 Even given a policy of insurance as I have described it, the policy is terminable at any time by the Company, and in the circumstances of a winding-up proceeding, the Provisional Liquidator is obliged in my view to terminate such

policies — or, at least, not to renew them. In my opinion, the Retirees are entitled to no more than the benefits of the coverage in effect and paid for at the time of the Winding-Up Order.

95 Each of the Life Policies and the Group Medical/Dental Plans provide that coverage will terminate when the earliest of the following events occurs:

a) the employer terminates the employee's coverage; or

b) the policy or the ASO contract terminates or coverage on the group, division or class to which the employee belongs terminates.

96 A winding-up is effective as of the date of the Notice of presentation of the petition for winding-up, and it is the duty of the liquidator to effect "a speedy, inexpensive and effectual distribution of the assets among the shareholders and creditors": see J.A. Carfagnini, *Proceedings Under the Winding-up Act (Canada)* (1988), 66 C.B.R. (N.S.) 77 at pp. 79-80; *Partington v. Cushing* (1906), 3 N.B. Eq. 322 (S.C.). The general principles governing a winding-up proceeding are described in *Ince Hall Rolling Mills Co. v. Douglas Forge Co.* (1882), 8 Q.B.D. 179 at p. 184 as follows [emphasis added]:

> In determining this question it is necessary to consider the effect upon the company and its operations of a petition for liquidation followed by a subsequent order to wind-up. In the first place, *the purpose of the winding-up is to make an equitable and rateable distribution of all the assets of the company, from the moment of the commencement of the winding-up*, that is the presentation of the petition, amongst all the creditors of the company without favour or preference to any one according to the legal rights of the creditors and the company at the moment of the commencement of the winding-up. All the assets of the company are to be got in and collected in the most beneficial way and distributed. *In fact, from the moment of the winding-up, the company is stopped as an independent going concern*.
>
> *Every transaction entered into by the company from that moment is void unless sanctioned by the Court; no contracts can be executed nor can the business of the company be carried on in a single particular except for the purposes of winding-up and for the benefit of the creditors*, and, although the company continues in existence and under the same name, and may, if allowed by the Court, continue to carry on its business and enter into or complete transactions, it does so in a new interest and a new capacity, and solely for the purpose of winding-up its affairs in the interest of its creditors and shareholders except in one class of cases which have no application to the present, viz., where transactions bonâ fide executed and carried out between the petition and the winding-up order may in the discretion of the court be ratified and confirmed.

97 Canadian courts have adopted a similar approach: see Carfagnini, supra, at p. 80.

98 Here, the ASO contracts in question were one year contracts. They expired on March 31, 1994. The Provisional Liquidator has indicated its intention to cease payments under the ASO contracts unless the Court orders otherwise, but has agreed to continue funding the Group Benefits until the issue has been determined. Leaving aside arguments having to do with the existence of trusts or other remedies, there is nothing in the "policyholder" submission itself, or in the relationship between the Company and the Retirees qua participants in the Group Benefits contracts which compels the Provisional Liquidator to continue to renew the contracts and to fund the Group Benefits. In my view, unless the Court orders otherwise, the Provisional Liquidator is obliged to discontinue the ASO contracts, in order to advance the liquidation of Confederation Life's assets as of the date of the winding-up and the distribution of those assets amongst the creditors according to law. In the circumstances of this case, there is no basis for the Court to order otherwise.

99 Although the Group Life benefits attract the same "policy of insurance" analysis as do the Major Medical and Dental benefits, and in addition have the advantage of being provided through contracts of insurance, they give rise to a similar problem for the Retirees. Confederation Life, as employer, implemented its contractual obligation to provide group life benefits through a series of contracts of insurance between the Trustees, as policyholder, and Confederation Life, as insurer. Although there is an insurance policy in existence with respect to these benefits, it, too, is an annual term

policy. Confederation Life pays the yearly premium out of the Company's general assets. The Life Policies also expired on March 31. Confederation Life is insolvent and can no longer pay the premiums. For the same reasons as it is not entitled to do so with respect to the Major Medical and Dental benefits, the Provisional Liquidator is obliged not to continue to pay the premiums for the Group Life benefits, in my view.

(ii) The Supplementary Pensioners and the Deferred Compensation Claimants

100 The "policyholder" arguments respecting the Supplementary Pensioners and the Deferred Compensation Claimants are founded on similar grounds. They proceed on a different basis than those of the Retirees, which were premised upon a contract of indemnity. Rather, the Supplementary Pensioners and the Deferred Compensation Claimants assert that *their* benefits constitute them policyholders because they are the owners or holders of an annuity which by definition, they assert, is a contract of life insurance.

101 Both the supplementary retirement income arrangements and the Deferred Compensation Plan call for payments to be made on retirement in a stream of periodic payments. In addition — in the case of the supplementary retirement income arrangements — the Claimant may elect to take a life annuity as provided under the Company's Registered Pension Plan.

102 Such arrangements, it is argued, constitute an undertaking to provide an annuity, i.e., a series of periodic payments, and annuities are life insurance policies for purposes of insurance legislation. Consequently, the submission concludes, the Supplementary Pensioners and the Deferred Compensation Claimants are the holders of policies of life insurance and entitled to rank as "policyholders" under para.161(1)(*c*) of the *Winding-up Act*, supra.

103 This argument has a certain plausibility about it, at first glance. However, it cannot withstand analysis in this context of employee benefits granted by a company which happens to be a life insurance company and which is being wound up. There are two reasons for this:

> 1) The supplementary retirement income benefits and the deferred compensation payments do not constitute true annuities, in my opinion, but are more in the nature of a pure debt; and,
>
> 2) Even if they do constitute an "annuity", as contemplated in the definition of "life insurance" in the *Insurance Act*, supra, they are not annuities provided by way of "an undertaking entered into by an insurer", as contemplated in that legislation.

Not a True Annuity

104 I accept that the benefits in question, if not placed in context, may be characterized as an "annuity" in the very broad sense in which that term is often employed. An annuity has been defined as broadly as simply "a contract ... for the payment of periodic amounts during the lifetime of a particular person, or for a fixed or guaranteed period": see D. Norwood, *The Uniform Life Insurance Law of Canada* (Toronto: Life Insurance Institute of Canada, 1974) at p. 18. See, to the same effect, *Black's Law Dictionary*, 6th ed.

105 An annuity, then, can be quite a sweeping concept. Indeed, it is one of those concepts which can be made to appear more sweeping than it is, in a given context, if one too slavishly adheres to broad dictionary definitions. As Thorson J. said, in *O'Connor v. Minister of National Revenue*, [1943] 4 D.L.R. 160 (Ex. Ct.) at p. 167, the term "annuity" "is a word that is often loosely and, therefore, ambiguously used".

106 Central to the concept of an annuity is the alienation of capital — the payment of a sum of money or other asset *of a capital nature* — which is then turned into a flow of income, so that the capital is used up and replaced by the flow of income. In *O'Connor v. Minister of National Revenue*, supra, Thorson J. said, at p. 167 [emphasis added]:

> Ordinarily an annuity is thought of as *a series of annual payments* which a person has *purchased or arranged for with a sum of money or other asset of a capital nature*. As Best J. said in *Winter v. Mouseley*, 2 B. & Ald. 802 at p. 806,

> 106 E.R. 558: "I have, however, always understood the meaning of an annuity to be where the principal is gone for ever, and it is satisfied by periodical payments."
>
> In 17 Hals. (2nd ed.), p. 181, this definition of an annuity is given: "An annuity is an income purchased with a sum of money or an asset, which then ceases to exist, the principal having been converted into an annuity."
>
> This accords with the ordinary acceptance of the term. The capital that went into the purchase of the annuity has been turned into a flow of income, so that the capital has disappeared altogether and only the flow of income continues.

107 See also *Coopérants, Société mutuelle d'assurance-vie/Coopérants, Mutual Life Insurance Society c. Raymond, Chabot, Fafard, Gaynon Inc.*, [1993] Q.J. No.1203 (C.A. Qué.) unofficial translation, paras. 92-96 (referred to hereafter as "*Coopérants*") [reported at 58 Q.A.C. 211].

108 It is the purchase of the future income stream with money or "other asset *of a capital nature*" which is the feature distinguishing an annuity from a mere debt. That feature, in my view, is lacking in the supplementary retirement income and deferred compensation arrangements. No sum of money or assets in the nature of capital were put forward either by the Claimants or by Confederation Life, in connection with the "purchase" of the future periodic income payments on retirement. While there is "consideration" for the payment of the income stream, in the form of the provision of labour and services to the Company, I am not prepared to hold in the circumstances of this case, that it is consideration of a capital nature in the sense that that concept is used in support of the purchase of an annuity.

109 No one would argue that the provision of labour in exchange for the payment of periodic salary amounts — i.e., an ordinary employment arrangement — constitutes that contract an "annuity" contract. The provision of future retirement income payments as partial consideration for employment services can be no different.

110 The same is true even with respect to the entitlement to elect a life annuity for the supplementary retirement income arrangements. Once again, the loose use of the word "annuity" can lead to misconceptions. While the life annuity granted under the Registered Pension Plan may very well be a true annuity — because it is backed by the making of capital contributions to the Plan by the employer, and by the general pre-funding which exists for such Plans — the Supplementary Pensioners are not entitled to such benefits qua supplementary retirement income claimants. There is no pre-funding for those benefits, nor any segregated amounts providing for their security. All the Supplementary Pensioners are entitled to do — those who are so entitled, at least — is to elect to take payments "in the same form and in the same manner as [they] elect for the pension income from the registered pension plan" (See the June 1993 Letter). It is a promise with respect to the manner of payment, not the establishment of an annuity in the true sense, as I understand it. It is simply the creation of a debt.

Not an Undertaking to Provide an Annuity by an Insurer

111 Even if the arrangements respecting the supplementary retirement income benefits and the deferred compensation claims do constitute "annuities", however, there is another reason why the Claimants in those categories are not entitled to succeed as "policyholders" of Confederation Life. The annuities are not issued by Confederation Life *as insurer*. They are promised by Confederation Life *as employer*. They are therefore not caught by the definition of "life insurance" in the *Insurance Act*, supra, in my opinion, and the Claimants are, likewise, not the holders of policies of life insurance as contemplated in para.161(1)(*c*) of the *Winding-up Act*, supra.

112 I accept that recent case law and amendments to insurance legislation have clarified the question of whether an annuity is "life insurance". In *Kerslake v. Gray* (1957), [1958] S.C.R. 3 the Supreme Court of Canada had ruled that such was not necessarily the case. Since that decision, however, many jurisdictions, including Ontario, have amended their legislation. Section 1 of the *Insurance Act*, supra, now defines annuities as a form of life insurance. It states [emphasis added]:

> "life insurance" means an undertaking by an insurer to pay insurance money,
>
> (*a*) on death,
>
> (*b*) on the happening of an event or contingency dependent on human life,
>
> (*c*) at a fixed or determinable future time, or
>
> (*d*) for a term dependent on human life, and, without restricting the generality of the foregoing, includes,
>
> . . . . .
>
> (*g*) *an undertaking entered into by an insurer to provide an annuity* or what would be an annuity except that the periodic payments may be unequal in amount and such an undertaking shall be deemed always to have been life insurance.

113 It appears to be accepted in the literature that "by definition, *all* annuity contracts now constitute life insurance": see Norwood & Weir, supra, at p.19. I do not agree, however. In the insurance law context it is an annuity or an undertaking to provide an annuity *entered into by an insurer, in its capacity as insurer*, which in my opinion meets that test. Neither the undertaking by Confederation Life to provide a supplementary retirement income stream of periodic payments — or the right to elect to take an annuity — nor the undertaking to make periodic payments to the Deferred Compensation Claimants, *in the circumstances of this case*, constitute such an undertaking given or entered into *by an insurer*. They are undertakings given or entered into by Confederation Life qua *employer*, not qua *insurer*. The fact that the Company happened to be an insurance company is a pure coincidence.

114 The decision of the Quebec Court of Appeal in *Coopérants* is instructive in this regard, I believe. In that case, Coopérants — an insolvent insurer — had issued deferred annuity contracts to individuals and to groups in the normal course of its business. Many were for the purpose of funding retirement savings plans. As in the case at Bar, the issue before the Quebec Court of Appeal was whether the owners or holders of the annuity contracts were entitled to the priority protection of "policyholders" under para.161(1)(*c*) of the *Winding-up Act*. The Court held that they were. Leave to appeal to the Supreme Court of Canada was refused [reported (sub nom. *Raymond, Chabot, Fafard, Gagnon Inc. c. Bouchard*) (1994), 170 N.R. 79 (note)].

115 The Court in *Coopérants* came to this conclusion largely on the basis that the Legislatures of most of the Provinces had responded to the decision in *Kerslake v. Gray*, supra, by modifying their respective statutes so that the definition of the term "life insurance" would include annuity contracts: [1993] Q.J., para.39 [p.221 Q.A.C.]. In the French language version of the legislation, annuities "are assimilated to life insurance". In the English language version "policy" includes "any annuity contract".

116 It is important to note, however, that all of the annuity contracts at issue in *Coopérants* were arm's-length transactions entered into by the company in the ordinary course of business. They were not "in-house" contracts designed to enable Coopérants to fulfil its obligations, qua *employer*, to its employees. At para.43, the Court stated [p.221 Q.A.C.]:

> All the contracts in question in this appeal were transacted within the framework of the business of a life insurance company with respect to the domain of retirement funds. Each and every one is linked to the various means generally offered by insurance companies to insure the capitalization and distribution of various pension plans.

117 The Court reviewed the history and evolution in the life insurance industry of the use of annuities as a primary financial services vehicle for the promotion of retirement savings plans. It pointed out that "for all of Canada in 1990, the annuities business by life insurance companies represented $11.853 billion, or 64% of the total premium revenues collected by life insurance companies" (para.45) [p.222 Q.A.C.]. In this context, and against this background, the Court concluded that by incorporating annuities into life insurance contracts the legislators had recognized the importance of annuities as a financial services product to the life insurance business and had dictated "an evolutive and dynamic interpretation of this practice that the courts must respect" (para.41) [p.221 Q.A.C.].

118 I note, however, that the "large and evolutive interpretation of the notion of annuity contract" adopted by the Court (para.77) [p.227 Q.A.C.] is applied in the context of arm's-length financial services products being marketed by life insurance companies to their customers. Such a broad definition of "annuity" is appropriate in the context of the sale of financial products by a life insurance company to its customers. It is not justified in the context of a life insurer, as employer, providing benefits to its employees as part of their compensation package, particularly where those benefits are in conflict with the statutorily protected rights of another group. In such circumstances, in my opinion, the Court ought not to strain to find an interpretation which would include classes of persons who would not, on a plain and ordinary meaning approach, be included in the protected group.

119 I believe this approach to the interpretation of the word "annuity" and the term "life insurance" is supported by the purpose behind the highly regulated and structured nature of the life insurance industry.

120 Brown & Menzies, *Insurance Law in Canada*, 2nd ed. (Toronto: Carswell, 1991) describe the supervision of the structure of the industry in this fashion (at p.26 [emphasis added; footnotes omitted]):

> As indicated, the federal statutes and legislation in force in most of the provinces address the question of insurer's solvency. Following two spectacular failures of insurance companies in England in 1867, *there developed considerable interest in Canada, as elsewhere, in protecting policy holders. The modern manifestation of that development is a comprehensive body of legislation providing for security deposits by insurers and for a system of supervision by government agencies*.

121 In *Coopérants* the Quebec Court of Appeal picked up this same theme in a passage that I have referred to, partially, elsewhere in these Reasons. I cite it in full here (paras.81-83) [p.228 Q.A.C.]:

> It would appear that the preservation of the financial security attached to an insurance policy was [the] underlying principle for the federal legislator when it stipulated that the claims of policyholders would be paid in priority in the event of the liquidation of a life insurance company.
>
> In assimilating an annuity contract transacted by an insurer to an insurance policy, the legislator even intended to preserve, due to the financial stability of insurance companies, the financial security attached to the annuity contract. An annuity and life insurance are, in effect, two means by which a person can protect himself against financial risks. Insurance permits an accumulation of a capital upon the death of the insured in order to protect the beneficiaries against the negative financial effects of death. The goal of an annuity is a liquidation of a patrimony (i.e., loosely translated, a body of invested capital) in order to ensure the annuitant a stable revenue during the protection phase.
>
> Insolvency and the winding-up of an insurance company are two events which threaten the protection and the financial security sought by the people who execute annuity contracts with an insurer, if they cannot benefit from the privileged status provided by the legislature in the Winding-Up Act.

122 The purpose of the regulatory scheme governing the insurance industry, and of the priority scheme enacted through s.161(1) of the *Winding-up Act*, supra, in my view, is to protect policyholders who invest funds with an insurance company. In such circumstances the regulatory scheme established under the *Insurance Companies Act*, supra, requires that an adequate reserve be established to cover the actuarial liability associated with the investment. What the "policyholder" priority of para.161(1)(*c*) does is to preserve access to that reserve by arm's-length purchasers of financial services products from life insurance companies, when such companies become insolvent.

123 It is not the senior officers of the Company — many of whom, including the Chairman and President, would have been at the helm in the period leading up to the collapse — whom the priority scheme is designed to protect. Vaulting the claims of such senior officers — and even the retired employees as well — into the same position as policyholders of the Company's products would mean ignoring the carefully constructed regulatory scheme which Parliament and the Legislatures have erected.

124 The only reason the Claimants are able to argue that their claims are claims of "policyholders" under the *Winding-up Act*, supra, is because the liquidation of their employer, Confederation Life, is the liquidation of an insurance company. Parliament, in my opinion, could not have intended to treat employees differently, in terms of priority on the liquidation of their employer, simply because of the nature of their employer's business. That, however, would be the result if the Claimants' position on the "policyholder" argument were to prevail. In my view, it cannot prevail.

125 I therefore hold that neither the Retirees nor the Supplementary Pensioners nor the Deferred Compensation Claimants are "policyholders" of Confederation Life, as that term is contemplated in para.161(1)(*c*) of the *Winding-up Act*, supra.

126 Finally, even if it could be said that the Claimants are "policyholders", as contemplated by s.161 of the *Winding-up Act*, supra, they would only rank, in the circumstances of this case, with "other creditors and *policyholders*" under subs.161(2), in my opinion. Ensuring the integrity of the legislative scheme of priority, intended as it is to protect arm's-length purchasers of insurance policies and annuities from insurers, commands nothing less.

127 I turn now to the issues of whether Confederation Life is bound by trust or fiduciary obligations in relation to its arrangements with the three groups of Claimants.

II. True or Express Trusts

128 All categories of Claimants are asserting the existence of an express trust in relation to their benefits.

129 For a Court to hold that a true or express trust exists, the party asserting the existence of such a trust must establish what are commonly referred to as "the three certainties". They are:

(i) certainty of intention on the part of the settlor to create a trust;

(ii) certainty of the subject matter of the trust i.e. the property to be settled upon the trustee in favour of the beneficiaries of the trust; and,

(iii) certainty of the object or persons intended to be the beneficiaries of the trust.

130 See: *Knight v. Boughton* (1840), *(*sub nom. *Knight v. Knight)* 49 E.R. 58 (Ch.) at p.68; D.W.M. Waters, *Law of Trusts in Canada*, 2nd ed. (Toronto: Carswell, 1984) at p.105.

131 In terms of pensions, it has been held that whether the pension arrangement is governed by contract or by trust principles depends upon the terms of the plan itself: see *Schmidt v. Air Products of Canada Ltd.*, [1994] 2 S.C.R. 611, 115 D.L.R. (4th) 631, at p.639 S.C.R., particularly per Cory J.

132 While, in determining whether or not there was an intention to create a trust, the use of the words "in trust", or "as trustee", or words to that effect is not essential, the evidence must be clear that the settlor did, indeed intend to create a trust; a general intention to benefit someone will not suffice to create a trust: *Re Allan Realty of Guelph Ltd.* (1979), 29 C.B.R. (N.S.) 229 (Ont. S.C.) at pp.241-242; *Jones v. Lock* (1865), 1 Ch. App.25 at pp.28-29; J.E. Martin, *Hanbury & Maudsely: Modern Equity*, 13th ed. (London: Stevens & Sons, 1989) at p.80. A Court will give weight to the absence of any reference to a trust in a pension plan, in determining whether there was an intention to create a trust: *Crownx Inc. v. Edwards* (1994), 20 O.R. (3d) 710 (C.A.), affirming (1991), 7 O.R. (3d) 27 (Gen. Div.).

133 In cases such as the present one, where what is argued is that the alleged settlor (Confederation Life) and the proposed trustee (the Confederation Life Trustees, or the Human Resources Committee acting under the direction of the Board of Directors) are in effect one and the same, particular difficulties arise. Waters, supra, at pp.150-151 deals with such difficulties in the following passage [emphasis added; footnotes omitted]:

> The principles applicable to this mode of making a gift are perfectly clear. The owner of the legal or equitable interest in the property in question must make it evident that he intends to constitute himself a trustee, *he must leave no doubt* as to what property interest of his is to be the subject of the trust, and he must similarly leave no doubt as to who is to be the trust beneficiary. In other words, the three certainties must be established as in the case of the creation of all trusts. As Jessel M.R. pointed out in *Richards v. Delbridge* [(1874), L.R. Eq. 11], however, an authority quoted in many Canadian judgments, it is not necessary that the donor use the words, "I declare myself a trustee": *words of any kind, and even conduct, are sufficient, provided it is satisfactorily shown that the donor did in fact intend to constitute himself a trustee*. ...
>
> The burden of proof that the donor intended to make himself a trustee is on those who allege such a trust, however, and many factors may reveal the true intent. ...

134 See also on this point *Re Garden Estate*, [1931] 4 D.L.R. 791 (Alta. C.A.).

135 On behalf of the Supplementary Pensioners in Pay and the Deferred Compensation Claimants, Mr. Matheson submits that the Supreme Court of Canada has recognized the special nature of promises made with respect to retirement benefits and that such promises should be viewed as trust promises, in recognition of the special vested rights acquired by retirees in connection with their benefits. Mr. Zigler and Mr. Robertson make a similar submission on behalf of the Retirees and Supplementary Pensioners Not in Pay, respectively. In support of this proposition they all rely upon the decision in *Dayco (Canada) Ltd. v. C.A.W.* (1993), 102 D.L.R. (4th) 609 (S.C.C.).

136 In *Dayco*, supra, the Supreme Court of Canada held that retirement benefits, depending upon the wording of the promise, could survive the expiration of a collective agreement. This is so because when a worker withdraws from the employer-employee relationship upon retirement, his or her accrued employment benefits crystallize into some form of "vested" retirement right and cannot subsequently be terminated or "divested": see *Dayco*, supra, at pp. 619, 637, 654 and 659, per La Forest J.

137 The key to the *Dayco* decision for the purposes of this case, however, is to be found in the statement of La Forest J. at p.637, that [emphasis added]:

> the old collective agreement is not rendered a nullity. *Rights that have accrued* under that agreement *remain enforceable*.

138 In short, the rights that have accrued to the retired employees cannot be terminated and may continue to be enforced. This is the essence of the "vesting" concept in this context. The right remains *enforceable*. Being *enforceable* is not necessarily the equivalent to being *secured* in the sense of pre-funded or the equivalent of being subject to a trust. There is nothing in *Dayco*, in my opinion, which leads to the conclusion that because the retirement benefits had become vested upon retirement, and therefore remained enforceable, they had become tantamount to trust benefits.

139 In my view, the claims of all categories of Claimants on the express trust ground cannot be sustained on the evidence and materials filed. They fail on at least two of the three "certainties", namely certainty of intention and certainty of subject matter. It may be that there is sufficient certainty in the description of the class of persons entitled to benefit in each case to meet the certainty of subject matter test — see Waters, supra, at pp.122-123 — but in view of the clear failure on the first two of the certainties, it is not necessary to determine that point with finality.

140 It is readily apparent that no segregated monies or assets were ever set aside or designated to fund either the Group Benefits, the supplementary retirement income arrangements or the Deferred Compensation Plan. Indeed the evidence and the materials filed are consistent only with the conclusion — and I so find — that the purported settlor, Confederation Life, had no intention of doing so and no intention of settling a trust.

141 With respect to the Group Benefits, the Company by-law stipulates that they may be altered or discontinued at any time, and the Guidelines absolve the Trustees of any responsibility for ensuring that the Group Benefit Plans are "funded". Whether or not the employees and Retirees were ever advised of these factors is not relevant to a consideration of the employer's intention. The Group Benefits were funded by yearly pay-as-you-go policies, and in the case of the Major Medical and Dental benefits these were "administrative services only" contracts.

142 In the case of the supplementary retirement income arrangements, what the Company authorized was a "retiring allowance", and what the Retirees were told in the Letters they received was that they were being provided with a retiring allowance. The retiring allowance was subject to three conditions, namely a non-compete, a confidential information agreement and an agreement to be available for consulting purposes, subject to health considerations. The imposition of conditions to the availability of the supplementary retirement income, it seems to me, is at least some indication that no express trust was intended. Moreover, the communications made it plain that the retiring allowance was not "vested" in the event that employment was terminated for cause, and Mr. Matheson candidly acknowledged that a benefit could not be vested for one purpose but be vested for another. While vesting is not equivalent to the creation of a trust claim, it would be some evidence of an intention on the part of the employer to establish an inalienable right to the benefit.

143 I note as well that the supplementary retirement income arrangements did not fall within the purview of the Confederation Life Trustees. Its administration was the responsibility of the Corporate Human Resources Department of the Company. This leads me to the conclusion — at least from the employer's perspective — that the Guidelines which applied to the Trustees with respect to the funding of the Registered Pension Plan did not apply to the supplementary retirement income benefits. Finally, it is patently obvious from the various Towers Perrin Reports and the failure of Confederation Life to make changes as a result of the advice contained in them, not only that the supplementary retirement income arrangements were unfunded and unsecured but that the Company had determined — undoubtedly because of the costs involved in doing so — not to alter that situation. Moreover, its practice in this respect was in keeping with that of most comparable Canadian corporations.

144 The November 1993 Towers Perrin Report states (at p.1):

> These benefits are paid monthly to retirees through "payroll". Unlike the registered plan benefits that are well funded and secure against any calamity happening to Confederation Life, receipt of these benefits is dependent on the future financial health of the company. This is consistent with common practice in Canada. Less than 10% of companies have funded or otherwise secured these kinds of obligations.

145 The April 15, 1994 Towers Perrin Report, addressed to Mr. Cunningham repeated the same theme:

> Securing retirement promises made to executives outside a registered pension plan has two major elements:
>
> • documenting the promise so that executives can prove their claim to benefits, and
>
> • setting up financial arrangements to fund the promises or to be available to provide the benefits if the company cannot.
>
> Confederation Life has dealt with the documentation issue and the current focus is on creating financial security. Our surveys show that over 90% of companies that have these promises have decided that they will not create any financial security other than by accumulating a book reserve on the balance sheet. They expect to provide the benefits on a pay-as-you-go basis from current revenue and they are not putting any backup in place to secure their promises. Only the rare company has decided to fund or otherwise secure their promises. The reason is cost. Creating security costs more than most companies want to pay.

146 In the case of the supplementary retirement income arrangements, there is the existence of the account — Account 2332G (later 20332) — in the Company's records to be considered. This Account did not represent segregated assets,

however, but was merely an accounting record created to record the accruing actuarial liabilities attributable to the supplementary retirement income arrangements, for bookkeeping purposes. It represents the accumulated book reserve on the balance sheet that Towers Perrin refer to. In a memorandum dated October 20, 1983, to Mr. Burns, and copied to Mr. Cunningham, the V.P. Corporate Actuarial & Finance (with whom Mr. Cunningham deposes he worked "to determine the level of contribution required to be put into account 2332G in order to meet pension benefit liabilities") reported that:

> "Pension" payments above the then ruling Revenue Canada maximum are not part of the pension plan obligations, *and must therefore be covered by the company's general funds*. The purpose of this memo is to discuss the size of this additional liability, and how to account for it.

147 The liability was accounted for by accruing it in account 2332G.

148 Payments to the Supplementary Pensioners were made out of the general funds of Confederation Life, not from any funds or assets in Account 2332G or its successor; and the records that were prepared to show the market value of the assets of what was called, for these purposes, the "Supplementary Pension", showed "zero". I am not prepared to hold that the establishment of such an account and the record keeping associated with it evidence conduct sufficient to demonstrate either the requisite declaration of trust or the requisite intention to create a trust on the part of Confederation Life.

149 Mr. Cunningham, himself, was well aware of the unfunded and unsecured nature of the Supplementary Pension arrangement. In a January 21, 1983 memorandum to Mr. Burns, the President, he wrote [emphasis added]:

> Retiring Allowance Programs are not usually pre-funded since such amounts are not tax deductible to the Company, and any investment income thereon would be taxable. As noted above, only the actual payments made can be deducted from income. The existence of a Retiring Allowance Program however does not necessarily create a contingent liability for the Company.
>
> . . . . .
>
> ... *If the Company did pre-fund* the additional liability, then a recommended rate would be 0.05% of payroll which translates into approximately $20,000 per year. The liability and cost for the Retiring Allowance Program would be reviewed annually at the same time as the Group Pension Plan valuation.

150 Each year the Company's pension consultants prepared an actuarial valuation for pension accounting in which the "Sr. Officers' Supplemental Pension Program (Non-Registered)" was included as one of five "Plans". The market-related value of the assets for that Program is consistently shown as "zero", however. This is of some significance because counsel for the Claimants rely heavily upon Note 13 to the Company's financial statements for the 1992 and 1993 fiscal years. That Note deals with Company pension costs, and states, in part:

> The Company maintains several pension plans which include substantially all employees. The latest actuarial valuations were completed for transaction to [fiscal year end] and projected to [calendar year end].

151 Note 13 showed that the "several pension plans" referred to had assets at market related values as of January 31, 1993, of $441,535,000 and an *excess* of assets over pension benefit obligations of $88,638,000. Counsel submit that the "several pension plans" include the foregoing reference to the Sr. Officers' Supplemental Program, and thus, that the Financial Statement — issued and approved by Confederation Life's Board of Directors — constitutes an express declaration of trust of the assets in question to the supplementary retirement income arrangements as well as the Registered Pension Plans.

152 I cannot agree. The Note is founded upon the pension consultants' annual report, which clearly distinguishes between the supplementary retirement income arrangements and the other Plans and attributes zero assets to the former. This is consistent with all of the other evidence.

153 Thus, neither the existence of account 2332G nor the references in the Notes to Confederation Life's Financial Statements can serve to found the existence of an express trust. Contributions were made each year to meet pension benefit liabilities, and they were accounted for in account 2332G; but they were made from the Company's general funds. There were no assets built up in the account to defray those payments. In this respect, Mr. Cunningham's "understanding", to which he deposed in his affidavit sworn February 13, 1995, "that the balance in account 2332G represented assets of the Company from which payments for pension benefits would be drawn" cannot be correct. It is inconsistent with all of the evidence.

154 The various factors which I have outlined regarding both the Group Benefits and the supplementary retirement income arrangements illustrate a lack of certainty both with respect to the intention to create a trust and with respect to the subject matter of the purported trust.

155 The same thing may be said for the Deferred Compensation Claims. No monies or assets were set aside to fund the deferred payments. In fact, the relevant document expressly states that such will not be the case and that credits to the accounting records in question were "entirely a matter of internal bookkeeping of the Employer".

156 Mr. Prophet argued, delicately, that the deferral of income in the given years by Messrs. Rhind and Burns had the effect of transferring or conveying that salary entitlement back to Confederation Life to be held in the Member's deferred compensation account, thus "settling" the amounts on the Company as trustee. By its conduct in accepting these contributions to the Plan and maintaining detailed ledgers for the deferred compensation accounts, he submitted, the Company manifested an intention that it would act as trustee with respect to the amounts credited from time to time to those accounts. This argument cannot succeed. It contradicts the very structure which gave the Deferred Compensation Plan its taxation validity, namely, that there would be *no* funds set aside in the account by either employer or employee to which the employee had any entitlement or power to control pending retirement. Moreover, Revenue Canada's advance ruling respecting the Plan is premised on the Plan being treated as a "retirement allowance" — a defined term under the *Income Tax Act* (Canada) and regulations — and on the agreement that it was not an "employee benefit plan" *or an* "*employee trust*" within the meaning of s.248 of the Act.

157 It remains to consider, on this aspect of the case, a reference in the Notes to Confederation Life's 1993 audited Financial Statements — the last such statement, and the only such reference — to "segregated trusteed funds". Each of the Claimant groups relies upon this reference. They submit it constitutes an express declaration of trust.

158 Note 1(g) to the 1993 Financial Statements states [emphasis added]:

> (g) Company pension costs and other employee benefits
>
> The Company maintains a variety of defined benefit pension plans for its employees and agents. The Company also provides other post-retirement life, health and dental insurance benefits for its employees and agents. *The assets supporting these benefits are held in segregated trusteed funds*.
>
> . . . . .
>
> The Company also provides certain health care and life insurance benefits for its employees upon retirement. Eligible employees are those who retire from the Company at normal retirement age. The cost of these benefits is expensed as the related insurance premiums are incurred.

159 The reference to "segregated trusteed funds" in relation to anything other than the Company's Registered Pension Plan appears to be a factual error, however. This is confirmed in a letter from Goodman & Goodman, solicitors for the Agent of the Provisional Liquidator, to counsel, dated February 10, 1995, which said:

> Our client has advised us that there were no "segregated trusteed funds" held in respect of the post retirement life, health and dental insurance benefits.

> We have been advised that discussions took place concerning amendment of the note ... It was intended to make it clear in future notes that the reference to "segregated trusteed funds" applied only to the defined benefit pension plan and not the other post retirement insurance benefits. We understand that Mr. Roger Cunningham was involved in these discussions and was aware of the foregoing.

160 It may be that the reference to segregated trusteed funds does not apply to the Retirees, in any event, because it is located in the passage from the Notes which relates to "employee" benefits, as opposed to the section of the Note dealing with health care and life insurance benefits "upon retirement", in which case it is plainly stated that the benefits are expensed. I do not need to base my conclusions with respect to the non-existence of an express trust on this latter consideration, however, as I am satisfied that an errant comment in a Financial Statement cannot operate to create a trust which did not otherwise exist.

161 For all of the foregoing reasons, I hold that the arguments of all Claimants based upon the alleged existence of an express trust must fail.

162 In dealing with this portion of the Claimants' arguments I have referred throughout to "express" trusts. It may be that the more appropriate expression would be "true" trusts, because the concept incorporates not only trusts created by express declaration, but also true trusts — meeting the three certainties — which necessarily arise by implication from the circumstances of the case. No such trusts exist here, expressly or by implication, in that sense. Counsel made their submissions utilizing the parlance of "express trust" — no doubt to distinguish those submissions from others relating to "constructive" trusts, which also arise by implication from the circumstances of the case — and I have followed that approach as well.

III. Constructive Trust

163

(1) Fiduciary Obligations

164 The Claimants argue that Confederation Life stands in a fiduciary relationship to them regarding their rights under the Group Benefit Plans, the supplementary retirement income arrangements, and the Deferred Compensation Plan. That fiduciary obligation, they submit, required the Company to put their interests ahead of its own and those of its policyholders in ensuring that these Employee Benefits were provided in a secured fashion. Confederation Life did not do so, thus breaching its fiduciary duties and therefore, the Claimants conclude, the Court should impress the Company's general assets with a constructive trust sufficient to fund the Retirees' Group Benefits, the supplementary retirement income arrangements and the Deferred Compensation Plan.

165 The fiduciary notion is an equitable concept of considerable sweep. It has enjoyed a significant evolution during the latter part of the 20th century. Its inherently flexible nature and broad scope is well summed up in the oft-cited remark of Arnup J.A. in *Laskin v. Bache & Co.* (1971), 23 D.L.R. (3d) 385, [1972] 1 O.R. 465 (C.A.), at p.392 D.L.R., that the categories of fiduciary, like the categories of negligence, are not closed. The existence of a fiduciary obligation, by its very nature, is founded upon the presence of some position of trust, confidence or loyalty, and it is the function of the fiduciary principle to monitor abuses of those factors which have been reposed by one person in another: see *Hodgkinson v. Simms*, [1994] 3 S.C.R. 377, [1994] 9 W.W.R. 609, at pp.404-405 S.C.R., per La Forest J. and at p.461 per Sopinka and McLachlin JJ.; *Keech v. Sandford* (1726), 25 E.R. 223.

166 In recent years the Supreme Court of Canada has had occasion to deal with the concept of fiduciaries on a number of occasions, and the following statement by Wilson J. (then in dissent) in *Frame v. Smith*, [1987] 2 S.C.R. 99 at p.135-136, is frequently cited — to use her words — as "a rough and ready guide" in determining whether a fiduciary relationship exists. She began the Supreme Court's search for "an underlying fiduciary principle" in this fashion:

> A few commentators have attempted to discern an underlying fiduciary principle but, given the widely divergent contexts emerging from the case law, it is understandable that they have differed in their analyses ... [references omitted] ... Yet there are common features discernible in the contexts in which fiduciary duties have been found to exist and these common features do provide a rough and ready guide to whether or not the imposition of a fiduciary obligation on a new relationship would be appropriate and consistent.
>
> Relationships in which a fiduciary obligation have [sic] been imposed seem to possess three general characteristics:
>
> > (1) The fiduciary has scope for the exercise of some discretion or power.
> >
> > (2) The fiduciary can unilaterally exercise that power or discretion so as to affect the beneficiary's legal or practical interests.
> >
> > (3) The beneficiary is peculiarly vulnerable to or at the mercy of the fiduciary holding the discretion or power.

167 This conceptual approach was followed in *Guerin v. R.*, [1984] 2 S.C.R. 335 and in *International Corona Resources Ltd. v. LAC Minerals Ltd.*, [1989] 2 S.C.R. 574. In *Hodgkinson v. Simms*, supra, it has been developed further. There, La Forest J., speaking for the majority (in the result), said at pp. 409-410 (S.C.R.) [underlining added]:

> In *Lac Minerals* I elaborated further on the approach proposed by Wilson J. in *Frame v. Smith*. I there identified three uses of the term fiduciary, only two of which I thought were truly fiduciary. The first is in describing certain relationships that have as their essence discretion, influence over interests, and an *inherent* vulnerability. In these types of relationships, there is a rebuttable presumption, arising out of the inherent purpose of the relationship, that one party has a duty to act in the best interests of the other party. Two obvious examples of this type of fiduciary relationship are trustee-beneficiary and agent-principal. In seeking to determine whether new classes of relationships are *per se* fiduciary, Wilson J.'s three-step analysis is a useful guide.
>
> As I noted in *Lac Minerals*, however, the three-step analysis proposed by Wilson J. encounters difficulties in identifying relation ships described by a slightly different use of the term "fiduciary", viz., situations in which fiduciary obligations, though not innate to a given relationship, arise as a matter of fact out of the specific circumstances of that particular relationship; see at p.648. *In these cases, the question to ask is whether, given all the surrounding circumstances, one party could reasonably have expected that the other party would act in the former's best interests with respect to the subject matter at issue.* Discretion, influence, vulnerability and trust were mentioned as non-exhaustive examples of evidential factors to be considered in making this determination.
>
> Thus, outside the established categories, what is required is evidence of a mutual understanding that one party has relinquished its own self-interest and agreed to act solely on behalf of the other party.

168 At p.412 (S.C.R.) La Forest J. continued [emphasis added]:

> As is evident from the different approaches taken in [*Norberg v. Wynrib*, [1992] 2 S.C.R. 226], the law's response to the plight of vulnerable people in power-dependency relationships gives rise to a variety of often overlapping duties. Concepts such as the fiduciary duty, undue influence, unconscionability, unjust enrichment, and even the duty of care are all responsive to abuses of vulnerable people in transactions with others. *The existence of a fiduciary duty in a given case will depend upon the reasonable expectations of the parties, and these in turn depend on factors such as trust, confidence, complexity of subject matter, and community or industry standards.*

169 This analysis is helpful, I believe, in the context of the case at bar. Employer-employee relationships are not per se fiduciary; they are based on contract, and grounded in the employer-employee relationship. There are many familiar instances, however, where employees have been found to owe fiduciary duties to their employers — situations involving the disclosure of confidential information, trade secrets, customer lists, competing businesses, for example. Nothing in

principle precludes the relationship existing in reverse, i.e., the imposition of a fiduciary obligation vis-à-vis its employees by the employer. It is a question of context, and the factual circumtances which exist.

170 Indeed, in *Stanton v. Reliable Printing Ltd.* (1994), 25 C.B.R. (3d) 48 (Alta. Q.B.) such a relationship was found to exist, and in the context of a winding-up proceeding. A printing company was wound up and all of its employees were dismissed without cause and without notice. The receiver sold the company's equipment. In a dispute with unsecured trade creditors the company's unionized former employees argued that they were entitled to priority for their pay out of the proceeds in lieu of notice. The employees succeeded. They succeeded because the existence of a provincial statutory scheme regard ing the protection of wages and the provisions of a collective agreement both created an environment in which the employer was obliged to safeguard the severance entitlements created for its employees. Acknowledging that the employer-employee relationship did not, in itself, create a fiduciary situation, Veit J. stated [at p.56; emphasis added]:

> I conclude that the nature of the relationship — which for centuries we thought was well described by the term "master-servant" — harbours a vulnerability and one that is not present in the relationship between the trade creditor and the employer. Time is a factor in that vulnerability, and so is the subservience to management. The nature of severance entitlements is similar to that of pensions: both are entitlements earned through employment. Both are vulnerable because the employee cannot have the employer's discretion in managing the business. Only one of these entitlements, has, however, been protected by statute [in the sense of establishing a statutory trust]. *However, if there were nothing more, the mere existence of the employer-employee relationship, as important and unique as that relationship is, might not entitle severance payments to the protection of a fiduciary designation. There may be a vulnerability without a requirement on the employer to act in the interests of the employee*. In this case, there are additional factors that must be taken into account in relation to that last obligation.

171 I agree with this analysis of the employer-employee relationship. Such a relationship does have aspects to it that differ from the straightforward arm's-length relationship of mere contracting parties. A person's place of employment is their working home. From an employer's perspective, an employee is not merely a supplier of goods or services, but a supplier of knowledge, skill and labour which, as the Confederation Life Employee Handbook notes, is the simple reason for the Company's success. Compensation — again, according to the Handbook — is designed "to provide a fair return for the contribution each staff member makes to the Company's operating success." In any employment situation, there are "power dependency" characteristics, although one cannot be categorical about the nature of these because it is a matter of degree in individual situations and, indeed, there may be circumstances in which the employees, rather than the employer, are in the "power" as opposed to the "dependency" position. The analysis which focuses upon the ability to exercise a discretion and to influence others' interests, and upon vulnerability, fits in certain circumstances — at least with respect to such things as employee programs that lie within the purview of the employer to create and to implement.

172 Nonetheless, the employer-employee relationship — which is the basis for the benefits flowing to all classes of Claimants here — is not per se fiduciary. It is not the sort of relationship which by itself has as its "essence" the kind of discretion, influence over interests, and *inherent* vulnerability "arising out of the inherent purpose of the relationship" which creates a rebuttable presumption "that one party has a duty to act in the best interests of the other party"; *Hodgkinson v. Simms*, supra, at p.409 (S.C.R.). As Veit J. noted in *Stanton v. Reliable Printing Ltd.*, supra, "there may be a vulnerability without a requirement on the employer to act in the interests of the employee".

173 The search for a fiduciary element in the employer-employee relationship, then, must move to the fact-driven analysis articulated by La Forest J. in *Hodgkinson*. Does a fiduciary obligation, although "not innate" to the relationship "arise as a matter of fact out of the specific circumstances of [the] particular relationship"? To assess this question, one must ask: Was it within the reasonable expectation of the parties that the employer would forsake its own interests and oblige itself to act solely in the interests of the employee in relation to the matter in question?

174 The exercise of assessing and weighing the applicability of the various fiduciary indicia to the facts of a particular case is a difficult one, requiring a careful consideration of the circumstances. Professor P.D. Finn, whose writings in this field are cited regularly in the highest courts, sums up the nature of the exercise very well, in my view, in the following

passage from an article entitled "The Fiduciary Principle", in T.G. Youdan, ed., *Equity, Fiduciaries and Trusts* (Toronto: Carswell, 1989) 1. He states [emphasis added]:

> If, from whatever combination of factual conditions, the parties in their relationship are so circumstanced that one is reasonably entitled to expect that the other is acting or will act in his interests, then that person should be entitled, on bare grounds of public policy to have that expectation protected.
>
> This said, the critical question is when will parties be found to be so circumstanced? *It is obviously not enough that one is in an ascendant position over another: such is the invariable prerequisite for the unconscionability principle. It is obviously not enough that one has the practical capacity to influence the other: representations are made, information is supplied (or not supplied) as of course with the object of, and in fact, influencing a host of contractual dealings. It is obviously not enough that the other party is in a position of vulnerability: such is the almost inevitable state in greater or lesser degree of all parties in contractual relationships. It is obviously not enough that some degree of trust and confidence are there: these are commonly placed in the skill, integrity, fairness and honesty of the other party in contractual dealings. It is obviously not enough that there is a dependence by one party upon the other: as the good faith cases illustrate, a party's information needs can occasion this. Indeed elements of all of the above may be present in a dealing — and consumer transactions can illustrate this — without a relationship being in any way fiduciary. What must be shown, in the writer's view, is that the actual circumstances of a relationship are such that one party is entitled to expect that the other will act in his interests in and for the purposes of the relationship.*

175 Balancing these factors in the context of this case, then, requires an examination of the Retirees' Group Benefit Plans, the supplementary retirement income arrangements, and the Deferred Compensation Plan. I have dealt at some length with these Employee Benefits in the section of these Reasons dealing with the Facts and in the context of the express trust arguments. Much of what was said in those contexts is also applicable to the constructive trust analysis, including the fiduciary analysis, and I will not repeat more than is necessary here.

176 As outlined above, the Confederation Life Group Benefit Plans had their origins in the mid-1920's and have continued to develop and to provide expanded and improved benefits since that time. The supplementary retirement income arrangements were a response, in the 1970's, to Revenue Canada limits on the amounts that could be paid from a registered pension plan, and an attempt to provide senior officers with the same proportionate retirement income that could be enjoyed by less highly remunerated employees. The Deferred Compensation Plan was a tax-planning device of the early 1980's.

177 None of these Employee Benefits were the result of negotiations or collective bargaining; nor did they find their way into some form of contractual document like a collective agreement. As far as I can determine from the evidence, changes in Group Benefits or supplementary retirement income arrangements were all implemented at the initiative of the Company, which then made available the improved benefits to its active and retired employees, advising them of the changes through revised versions of the Booklets, Handbooks and Retirement Pamphlets issued from time to time.

178 The Company By-Law, which set up the current Group Benefit Plans in 1955, while establishing a Board of Trustees to administer the Plans, makes it clear that: (1) the benefits will be determined by Confederation Life from time to time and (2) the Company's Board of Directors can at any time cause the benefits to cease. The practice with respect to changes in the benefits has been quite consistent with the first of these provisions, and, while they have not always done so, the Employee Handbooks and Retirement Pamphlets as they existed at the time of the Winding-Up Order reflect the latter.

179 The Group Benefit Plans are not pre-funded, supported by any segregated trust funds, or secured in any other way. They are "pay-as-you-go" plans. The Life Policies are funded on a yearly renewable term basis through experience-rated policies issued by Confederation Life itself. The Major Medical and Dental benefits are provided through administrative-services-only contracts which, as the Handbooks note "are not insured". Nothing is to be found, anywhere in the evidence,

to the effect that the employer was obliged to, or, indeed intended to pre-fund or secure the payment of the Group Benefits in any fashion; nor is there anything to indicate that the employees expected such to be done.

180 The same is true with respect to the supplementary retirement income arrangements. They are not pre-funded or secured, and all of the Company documentation emanating from the officers involved in dealing with the subject indicates a recognition and understanding of that fact. The July 16, 1975 Resolution of the Board which authorizes this benefit, simply authorizes that senior officers be provided upon retirement with a retirement allowance "as authorized by the Board of Directors", suggesting, as Mr. Burns points out in a later memorandum, that each case is to be individually considered at the time of retirement. There is nothing in either the April 1983 Letters sent to eligible officers or in Mr. Cunningham's subsequent "clarifying" June 1993 Letter which suggests that the supplementary entitlement is pre-funded or otherwise secured.

181 In the context of the Deferred Compensation Plan, the circumstances are even clearer in this respect. The strictures of the *Income Tax Act* (Canada) and the advance ruling obtained from Revenue Canada make it clear that no monies were being set aside or deposited anywhere by Confederation Life to fund or protect the deferred payments. Any records kept of Mr. Rhind's and Mr. Burn's entitlement, including interest accumulations, were merely for bookkeeping purposes.

182 I note as well — again — the comments of Towers Perrin. Over 90% of companies which have outstanding retirement promises to executives provide for the benefits in question on a pay-as-you-go basis without creating any financial security, because of the high cost of doing otherwise. From the shareholders' perspective, such costs can rarely be justified.

183 In short, in my view, the evidence does not support a finding that there was a mutual understanding the Employee Benefits would be pre-funded or secured, and there is nothing upon which to base a finding that the employees had any reasonable expectation that Confederation Life had undertaken to subordinate its own interests, and those of its policyholders, to those of the employees and retirees with respect to the establishment of such benefits. On that basis, the very important ingredient for the creation of a fiduciary relationship, namely, the relinquishing of one's own self-interest and agreeing to act solely in the interests of, and on behalf of, the other party, is missing: *Hodgkinson v. Simms*, supra, at pp. 409-410 and 412 (S.C.R.).

184 I conclude, in the circumstances of this case, that Confederation Life did not stand in a fiduciary relationship towards the Retirees, the Supplementary Pensioners or the Deferred Compensation Claimants in relation to the provision of the Employee Benefits or, at least, in relation to an obligation to pre-fund or secure such Plans.

185 Counsel argued on behalf of the Claimants that Confederation Life is precluded from terminating their benefits because those benefits had "vested" and because the Company had not given adequate or any warning to the Claimants that the benefits could be terminated. Where rights have vested at the time of retirement, they submitted, the employer may not divest such rights or thereafter decrease (although it may increase) the benefits: see *Dayco*, supra. Moreover, if the employee Booklets, Handbooks and Retiree Pamphlets do not warn the beneficiaries of the possibility that benefits could be terminated, the Company should not be allowed to rely on the Plan documents to terminate the Benefits; nor should it be allowed to rely upon a term of the Plans that it kept secret from the retirees: *James v. Richmond Hill (Town)* (1986), 54 O.R. (2d) 555 (H.C.) at p. 561, per Griffiths J.; *Madott v. Chrysler Canada Ltd.* (1989), Labrosse J. (Ont. H.C.), unreported; *Daniels v. Canadian Tire Corp.* (1991), 5 O.R. (3d) 773 (Gen. Div.) at p. 777, per McMurtry A.C.J.O.C.

186 In my view these arguments do not advance the Claimants' position. As I have indicated earlier in these Reasons, they fail to distinguish between the concept of "vesting", which relates to the locking-in of an entitlement, and the obligation to fund a benefit flowing from that entitlement. In the absence of an obligation to pre-fund or otherwise secure the Employee Benefits, the fact that they may be vested in the Claimants upon their retirement is small comfort to them. Similarly, if indeed the Company is in breach of an obligation not to terminate the Plans — which I do not find — that breach is of little consequence, in the context of the winding-up, unless it can be remedied by way of some access to a segregated part of Confederation Life's general assets or to some assets impressed with a trust.

187 As there is no fiduciary relationship between the Company and the Claimants in relation to the Employee Benefits, there can be no constructive trust imposed as a remedy for breach of the obligations arising out of such a relationship. This leaves the question of whether a constructive trust should be imposed on the basis of unjust enrichment.

(2) Unjust Enrichment

188 I conclude that it should not.

(a) Unjust Enrichment: The Three-fold Parameters

189 The principles which give rise to the imposition of a constructive trust, based upon unjust enrichment, require the finding of a benefit to or enrichment of one party, a corresponding detriment to or deprivation suffered by the other party, and an absence of any juristic reason for the benefit or enrichment: see *Rathwell v. Rathwell*, [1978] 2 S.C.R. 436; *Becker v. Pettkus*, [1980] 2 S.C.R. 834; *Sorochan v. Sorochan*, [1986] 2 S.C.R. 38; *LAC Minerals*, supra; *Peter v. Beblow* (1993), 101 D.L.R. (4th) 621 (S.C.C.).

190 In *Rathwell*, supra, Dickson J. (as he then was) formulated the principle in this fashion (at p. 455 [emphasis added]):

> The constructive trust, as so envisaged, comprehends the imposition of trust machinery by the court in order to achieve a result consonant with good conscience. As a matter of principle, the court will not allow any man unjustly to appropriate to himself the value earned by the labours of another. That principle is not defeated by the existence of a matrimonial relationship between the parties; *but, for the principle to succeed, the facts must display an enrichment, a corresponding deprivation, and the absence of any juristic reason — such as a contract or disposition of law — for the enrichment*.

191 While most of these leading authorities emanating from the Supreme Court have been cases dealing with those concepts in family law matters, it is clear that the principles have equal application in commercial contexts. *LAC Minerals*, supra, for instance, involved a commercial transaction.

192 As I shall explain, I am doubtful that the benefit-detriment dichotomy which exists in the circumstances of this case amounts to the type of corresponding enrichment and deprivation contemplated by the unjust enrichment principle. I do not think it matters for these purposes, though, because in my view the claims of the Retirees, the Supplementary Pensioners, and Messrs. Rhind and Burns all fail to meet the "absence of juristic reason" test, and thus an unjust enrichment claim is not made out. Moreover, I would not in any event impose the constructive trust remedy sought, as I do not believe it would be appropriate in this instance to do so. There is not a sufficient connection between the contributions of the Claimants and the assets which it is sought to impress with the trust; and, in addition, the winding-up/insolvency context of proceedings brings a dimension to the analysis which works against the application of constructive trust principles which would place the Claimants in an advantageous position over other Confederation Life claimants.

The "Enrichment-Detriment" Analysis

193 In carrying out the enrichment-detriment analysis the Courts have generally taken an economic approach, recognizing these elements as the "morally neutral" components of the mix, and looking to the third element, that of the absence of juristic reason for the enrichment, as the source of "unjustness". As stated by McLachlin J. in *Peter v. Beblow*, supra, at p. 645:

> This court has consistently taken a straightforward economic approach to the first two elements of the test for unjust enrichment: *Pettkus v. Becker, supra; Sorochan v. Sorochan* (1986), 29 D.L.R. (4th) 1, [1986] 2 S.C.R. 38, 23 E.T.R. 143; *Peel (Regional Municipality) v. Canada* (1992), 98 D.L.R. (4th) 140, [1992] 3 S.C.R. 762 [...] It is in connection with the third element — absence of juristic reason for the enrichment — that such considerations (those outlined earlier in her Reasons) may more properly find their place. It is at this stage that the court must consider whether the enrichment and detriment, morally neutral in themselves, are "unjust".

194 In addition, in terms of the enrichment-detriment consideration, the courts have indicated that once enrichment has been found, the conclusion that the plaintiff has suffered a corresponding deprivation is virtually automatic — two sides of the same coin, as it were: see *Peter v. Beblow*, supra, at pp. 631-632, per Cory J.

195 Accordingly, on this analysis, if Confederation Life has received a benefit in economic terms and the Claimants have suffered a detriment in economic terms, the first two elements of the unjust enrichment test will have been met. I accept that each of the Complainants will suffer a detriment if the provisions of the benefits under the Group Benefit Plans, the supplementary retirement income arrangements and the Deferred Compensation Plan are not continued during their retirement, as promised. I also accept that Confederation Life has benefitted either by the provision of their labour and employment services — in the context of the Retirees and Supplementary Pensioners — or from the control over and use of the funds that Messrs. Rhind and Burns elected to defer from their incomes in the years in question under the terms of the Deferred Compensation Plan.

196 As I have indicated and shall explain momentarily, however, I am not satisfied that the enrichment/detriment circumstances of this case fall within that concept as contemplated in the unjust enrichment authorities.

Absence of "Juristic Reason"

197 While a number of authorities discuss the question of what factors should be taken into account in determining whether there is an absence of juristic reason for the enrichment, none that I have reviewed deal with the question of what the phrase "juristic reason" actually means. In *Rathwell*, supra, where the phrase appears to have originated, Dickson J. used the expression "such as a contract or disposition of law" in giving examples of what could amount to "an absence of any juristic reasons ... for the enrichment" (p. 455). He considered the notion further in *Sorochan*, supra, saying (at p. 46 [emphasis added]):

> The third condition that must be satisfied before a finding of unjust enrichment can be made is also easily met on the facts of this case. There was no juristic reason for the enrichment. Mary Sorochan *was under no obligation, contractual or otherwise*, to perform the work and services in the home or on the land.

198 Cory J. was of a similar view in *Peter v. Beblow*, supra, stating at p. 363 [emphasis added]:

> When a claimant is under *no obligation contractual, statutory or otherwise to provide the work and services* to the recipient, there will be an absence of juristic reasons for the enrichment.

199 That the concept of "juristic reasons" is a broad one, involving many factors, and that it is the element in the unjust enrichment exercise which involves an examination of the "unjustness" of the situation, is apparent from the following statement of Madam Justice McLachlin in *Peter v. Beblow*, supra, at p. 645:

> It is in connection with the third element — absence of juristic reason for the enrichment — that such considerations may more properly find their place. It is at this stage that the court must consider whether the enrichment and detriment, morally neutral in themselves, are "unjust".
>
> What matters should be considered in determining whether there is an absence of juristic reason for the enrichment? The test is flexible, and the factors to be considered may vary with the situation before the court. ...
>
> In every case, the fundamental concern is the legitimate expectation of the parties ...

200 The need to consider the parties' expectations and whether retention of the benefit would be "unjust" is emphasized by Dickson J. in *Becker v. Pettkus*, supra, at pp. 848-849 and again in *Sorochan*, supra, at p. 46. "The test put forward" in this respect, according to Cory J., "is an objective one": *Peter v. Beblow*, supra, at p. 635.

201 The caselaw indicates that a contractual debtor-creditor relationship will be sufficient to establish the existence of a juristic reason for an enrichment that can be accounted for on the basis of that contrac tual relationship. I note, for example, the decision of the Saskatchewan Queen's Bench in *Royal Bank v. Pioneer Trust Co. (Liquidator of)* (1988), 68 C.B.R. (N.S.) 124 and the decision of the Ontario Court of Justice (General Division) in *Pikalo v. Morewood Industries Ltd. (Trustee of)* (1991), 7 C.B.R. (3d) 209. Both of these decisions arose in an insolvency context.

202 In *Pioneer Trust*, supra, the trust company had obtained $30,000 in cash from the Royal Bank on February 7, 1985, in exchange for a cheque in the same amount in favour of the Royal Bank. Later that day the Minister of Finance directed the Superintendent of Insurance to take control of Pioneer Trust's assets. Proceedings under the *Winding-up Act* were commenced, and a liquidator was appointed. The cheque was returned to the Royal Bank. The Royal Bank submitted a claim to the liquidator. It then brought an action, claiming, among other things, that the liquidator held the sum of $30,000 in trust for it as a constructive trustee.

203 In dealing with this claim Gerein J. readily accepted that there was an enrichment and corresponding deprivation. However, because the parties were in a debtor-creditor relationship there was a juristic reason for the enrichment. According to Gerein J. at p. 133:

> It is not unjust in law to hold the plaintiff to that status with the attendant consequences. To do otherwise would have no basis in law and would cause wrongful harm to the other creditors.

204 In *Pikalo*, supra, Chadwick J. dealt with a claim for a constructive trust by a lessor in the context of a bankruptcy of the lessee. The court viewed the lessor as an unsecured creditor and described the relationship between the parties as being "purely contractual". In holding that this fact took the claim outside the realm of constructive trust, Chadwick J. said at p. 214:

> As in most bankruptcy cases, the unsecured creditor may suffer financial hardship in the appearance of an unjust enrichment or benefit to either the bankrupt estate or a secured creditor, such as the bank in this case.

205 Finally, it appears that the absence or presence of a juristic reason in connection with the enrichment need not necessarily arise out of any relationship between the party asserting the claim for unjust enrichment and the party enriched: see *Royal Bank v. Harowitz* (1994), 17 O.R. (3d) 671 (Gen. Div.); *807933 Ontario Inc. v. Allison (Trustee of)* (1995), *(*sub nom. *Re Allison)* 22 O.R. (3d) 102 (Gen. Div.). This is of some significance here because it is Confederation Life's other creditors, rather than Confederation Life itself, who will "benefit" if the Company's assets are not impressed with a constructive trust to secure the Group Benefits, the supplementary retirement income arrangements and the Deferred Compensation Plan.

206 Several propositions can be distilled from the foregoing authorities respecting the concept of "juristic reason", it seems to me. They may be summarized as follows:

> (i) An obligation to make the contribution which leads to the enrichment — whether that obligation arises in a debtor-creditor or other contractual context, or whether by reason of the principles of common law or of equity, or whether it arises by way of a statutory provision — may constitute a juristic reason.
>
> (ii) The reasonable expectations of the parties must be considered, in particular, whether the party providing the contribution leading to the enrichment did so with a reasonable expectation of receiving an interest in property, and the other party knew or ought to have known of this reasonable expectation. The test in this respect is an objective one.
>
> (iii) It must be evident that the retention of the benefit would be "unjust" in the circumstances of the case.
>
> (iv) Finally, the juristic reason for the enrichment need not always be tied irrevocably to the person who asserts the unjust enrichment but may arise out of a relationship between the person enriched and some other person.

207 In short, a "juristic reason" simply means some underlying justification, grounded in a legal or equitable base, for the circumstances that have arisen, notwithstanding that the benefit/detriment equilibrium has since become unbalanced.

208 There are, as I shall outline, a number of such reasons underlying the imbalance in this case.

(b) Unjust Enrichment: Gateway to Constructive Trust

209 A finding of unjust enrichment provides a gateway to the imposition of a constructive trust. It does not automatically open the gate, however. The process is two-staged. If an unjust enrichment has occurred the next step is to determine whether the imposition of a constructive trust *is an appropriate remedy in the circumstances*.

210 At the outset it is wise, I think, to heed the caution expressed in the judgment of La Forest J. in *LAC Minerals*, supra. At pp. 677-678 (S.C.R.) he states [emphasis added]:

> I do not countenance the view that a proprietary remedy can be imposed whenever it is "just" to do so, unless further guidance can be given as to what those situations may be.
>
> . . . . .
>
> Much of the difficulty disappears if it is recognized that in this context the issue of the appropriate remedy only arises once a valid restitutionary claim has been made out. The constructive trust awards a right in property, but that right can only arise once a right to relief has been established. *In the vast majority of cases a constructive trust will not be the appropriate remedy. ... [A] constructive trust should only be awarded if there is reason to grant to the plaintiff the additional rights that flow from recognition of a right of property*.

211 The focus of the enquiry, then, should be on whether there is a justifiable reason for recognizing a right of property in the claimant, or what is tantamount to a right in property — which would be the effect in the Confederation Life context of impressing the Company's general assets with a trust to secure the Claimants' claims.

212 A number of guideposts have been established by the courts to help in navigating the path between the unjust enrichment gateway and the imposition of a constructive trust. They include:

a) whether a monetary award would be sufficient in the circumstances;

b) whether there is a sufficient factual connection or link between the contribution leading to the unjust enrichment and the property or asset in question;

c) whether the claimant reasonably expected to obtain a proprietary interest in the property or asset; and,

d) whether the competing equities point toward the imposition of a constructive trust.

Monetary Award Insufficient — The Inadequacy Consideration

213 It is obvious that a monetary award would be of little assistance to the Claimants in this case, in view of the winding-up and insolvency of Confederation Life. As Bell J. noted, in *Barnabe v. Touhey* (1994), 18 O.R. (3d) 370 (Gen. Div.) at p.379 [emphasis added]:

> In my view, none of the remedies suggested, other than the declaration of a constructive trust, would be appropriate in this case. A simple money judgment would not be a satisfactory remedy here *given the bankruptcies of Touhey and Sigouin*. In *Jesionowski v. The* "*Wa-Yas*", [1993] 1 F.C. 36 at p.58, 55 F.T.R. 1 at p.27, Reed J. stated that, before a constructive trust is awarded, there must be some special reason to grant the plaintiff the additional rights which would flow from a right to property. She listed examples of special reasons including "a need to give priority to the plaintiff in a bankruptcy situation". I agree.

214 I think it warrants noting, however, that the mere fact of insolvency and the mere "need to give priority" to a claimant in such a situation is not, by itself, sufficient to trigger the automatic application of the constructive trust mechanism. Priority is almost always a "need" for someone in an insolvency. Tempered against the inadequacy consideration is the need to be aware of the effect of a declaration of constructive trust in such a context — the beneficiary of the trust essentially becomes a secured creditor, thus taking priority over all other unpaid general creditors. Hence the imposition of a constructive trust cannot be an automatic consideration simply because a monetary award is obviously not an adequate remedy. While priority will almost always be required by the claimant in an insolvency, it must also be just and appropriate in the circumstances to make an order that will have the effect of granting it.

A Connecting Link

215 The Supreme Court of Canada has held that in order to impose a constructive trust — and thereby, in effect, to recognize the claimant as a beneficial owner of the property in question — there must be a factual connection between the unjust enrichment and the property or asset in question.

216 Dickson J. described the requirement in *Becker v. Pettkus*, supra, at p.852, in these words [emphasis added]:

> For the unjust enrichment principle to apply it is obvious that some connection must be shown between the acquisition of property and corresponding deprivation. On the facts of this case, that test was met. The *indirect contribution of money and the direct contribution of labour is clearly linked to the acquisition of property*, the beneficial ownership of which is in dispute ... *The question is really an issue of fact: was her contribution sufficiently substantial and direct* as to entitle her to a portion of the profits realized upon the sale of the Franklin Centre property and to an interest in the Hawkesbury properties, and the beekeeping business?

217 In *Sorochan*, supra, the Chief Justice elaborated upon this view. At p.50, he said [emphasis added]:

> These cases reveal the need to retain flexibility in applying the constructive trust. In my view, the constructive trust remedy should not be confined to cases involving property acquisition. *While it is important to require that some nexus exist between the claimant's deprivation and the property in question, the link need not always take the form of a contribution to the actual acquisition of the property. A contribution relating to the preservation, maintenance or improvement of property may also suffice*. What remains primary is whether or not the services rendered have a "clear proprietary relationship", to use Professor McLeod's phrase. When such a connection is present, proprietary relief may be appropriate. ... As stated in *Pettkus* ... "The equitable principle on which the remedy of constructive trust rests is broad and general; its purpose is to prevent unjust enrichment in whatever circumstances it occurs."

218 There need not be an already recognized right of property before the constructive trust may be imposed. As a remedy, it may be used *to create* a right of property in appropriate circumstances, thus obviating the need to find a pre-existing property right by means of equitable tracing rules: see *LAC Minerals*, supra, at p.676, per La Forest J.; and *Peter v. Beblow*, supra, at p.639, per Cory J.

219 Once it is established that the claimant's contribution is "sufficiently substantial and direct" to entitle him or her to a property interest, the extent of the property interest must be determined. In general, the amount of the contribution governs the extent of the constructive trust; it must be proportionate to, or reflect the extent of, the contribution of the claimant to the property: *Becker v. Pettkus*, supra, at p.277; *Peter v. Beblow*, supra, at p.651.

Reasonable Expectations

220 Another consideration in the analysis of whether a constructive trust is the appropriate remedy is whether the claimant reasonably expected to obtain an actual proprietary interest as opposed to monetary relief: see *Sorochan*, supra, at p.52; and *Peter v. Beblow*, supra, at p.637. As stated by Dickson C.J.C. in *Sorochan* at p.52-53 [emphasis added]:

> A reasonable expectation of benefit is part and parcel of the third pre-condition of unjust enrichment (the absence of a juristic reason for the enrichment). At this point, however, in assessing whether a constructive trust remedy is appropriate, *we must direct our minds to the specific question of whether the claimant reasonably expected to receive an actual interest in property and whether the respondent was or reasonably ought to have been cognizant of that expectation*.

Competing Equities

221 Equitable remedies entail the necessity of balancing interests. In the context of a constructive trust claim against the assets of an insolvent constructive trustee, it is important to be aware of the interests of the insolvent's other creditors as well as those of the constructive trust claimant. In particular, in the context of this case, it is important to be aware of the interests of the general policyholders of Confederation Life. Widows and widowers, and those who will depend upon the viability of their life insurance policies and annuities when they become widows and widowers, are no less a group in need of protection and deserving of concern than are retired employees, supplementary pensioners and deferred compensation claimants. In fact, the statutory scheme which governs an insurance company winding-up accords them a stipulated priority. This factor cannot be ignored.

222 In *Coopérants* the Quebec Court of Appeal ascribed the following rationale to the *Winding-up Act* scheme, in a passage cited earlier (para.81 [p.228 Q.A.C.; emphasis added]):

> It would appear that the preservation of the financial security attached to an insurance policy was [the] underlying principle for the federal legislator when it stipulated that the claims of policyholders would be paid in priority in the event of the liquidation of a life insurance company. *The Winding-up Act demonstrates the desire of the legislator to protect people who put their confidence in an insurance company because they are generally institutions whose financial stability is not in doubt.*

223 In this context, then, who is it who can more readily be said to have accepted the risk of the Company's insolvency in their dealings with it? Is it the policyholders who have purchased its financial services at arm's length, putting their confidence in it in that sense as an institution "whose financial stability is not in doubt"? Or is it the Retirees, Supplementary Pensioners and Deferred Compensation Claimants, who also placed their confidence in the Company but did so more in its capacity as an employer and provider of the Employee Benefits than as a provider of institutional financial services? Some authors have suggested that one way to approach the matter of whether someone should be granted a preference over other creditors in an insolvency situation through the application of the constructive trust doctrine, is to ask whether that person, or group of persons, accepted the risk of the constructive trustee becoming insolvent: see D.M. Paciocco, "The Remedial Constructive Trust: A Principled Basis for Priorities over Creditors" (1989), 68 Can. Bar Rev. 314; J.D McCamus, "The Restitutionary Remedy of Constructive Trust" (1981) Law Society of Upper Canada, Special Lectures, *New Developments in the Law of Remedies* 89.

(c) Unjust Enrichment in Relation to the Facts Here

224

(i) The Retirees

225 The Retirees' claim to succeed on the basis of unjust enrichment founders, in my view, on the shoals of both the "benefit-detriment" analysis and the "juristic reason" analysis. In addition, even if an "unjust enrichment" could be said to have occurred in these circumstances, the remedy of impressing the general assets of Confederation Life with a constructive trust sufficient to fund the Group Benefit plans ad infinitum — or at least until all eligible claimants had retired and ceased to make claims — would be inappropriate. It would be inappropriate in the circumstances because there is not a sufficient connection between the benefits/detriment and the assets in question, in my opinion; and it would be inappropriate because in the balancing exercise of weighing the interests of the Retirees against those of the

policyholders, in this insolvency and winding-up situation, Parliament has said that the policyholders are to be given priority: the *Winding-up Act*, supra, s. 161(1).

Enrichment/Detriment

226 Is there a benefit or enrichment, on the part of Confederation Life, and a corresponding detriment or deprivation, on the part of the Retirees, as contemplated by the doctrine of unjust enrichment, in the circumstances of this case? I conclude that there is not.

227 To be sure, it can be said that Confederation Life has benefitted from the services of its former employees, and that they, in turn, will suffer a detriment as a result of the cessation of the Group Benefits. A deeper analysis is necessary in my view, however, than is reflected in that simple overview in order to resolve the dilemma before the Court.

228 The circumstances here are different than those usually characterizing an unjust enrichment case. One generally asks the question whether it is right that the beneficiary of the enrichment be allowed to keep the benefit or be permitted to continue to enjoy the enrichment. Here, however, Confederation Life does not enjoy a benefit or an enrichment in that sense. Its "enrichment" lies in having received in the past the benefit of the retired employees' labour, skills and knowledge. The "deprivation" of the Retirees lies in the future partial failure of the consideration for those contributions, i.e., in the future loss of the Group Benefits which formed part of their compensation package. That deprivation, though, is not related to the enrichment; rather it relates to the Company's financial collapse. In short, the circumstances give rise to a rare exception to the proposition that "once enrichment has been found, the conclusion that the plaintiff has suf fered a corresponding deprivation is virtually automatic": see *Peter v. Beblow*, supra, at p. 631, per Cory J.

229 The imbalance in the benefit/detriment equilibrium here arises as a result of the winding-up and liquidation of the Company. It does not result from some unfair "taking advantage" by the person benefitting from the enrichment. What happened, in Mr. Grout's colourful but succinct description, is simply that "Confederation Life went bust". Until the Company's unexpected financial collapse in August 1994, the retiree/former employer relationship worked quite well, in terms of the Group Benefits. Confederation Life honoured its obligations. The Retirees received the Group Benefits which formed part of the compensation package governing the terms of their former employment.

230 It may be argued that the "enrichment" in these circumstances arises because Confederation Life has had the advantage of the retired employees' services without having to bear the cost of providing the Group Benefits on a pre-funded, fully-secured basis and that its policyholders and creditors will be enriched in the winding-up proceedings if the Company's assets are not called to account for that necessary pre-funding or security. While I think it is not untoward to consider the interests of the Retirees in contrast to those of the policyholders and creditors in the "benefit/detriment" exercise, the issue to be determined is whether there was an obligation to pre-fund or secure the Group Benefits. It is not permissible to define the benefits/detriment equation, which is a stepping stone toward the determination of that issue, by predetermining the issue.

231 Thus, in my view, there has not been an enrichment and a corresponding deprivation in the circumstances of this case which could give rise to a finding of unjust enrichment.

Juristic Reason

232 Even if I am in error in arriving at the foregoing benefit/detriment conclusion, however, I also find there are several juristic reasons for any benefit or enrichment that the Company may have received.

233 The first is to be found in the contractual/employment relationship between the parties. Where services are rendered pursuant to a contract and in accordance with the terms of the contract, the contract constitutes a juristic reason for a deprivation. Here, the Retirees had provided their labour, skills and knowledge to Confederation Life in accordance with their contractual employment arrangements; conversely, the Company had benefitted from those contributions and agreed to remunerate the former employees through a compensation package which featured, as one important aspect

of it, provision of the Group Benefits. Thus, unlike in the matrimonial cases in the context of which the principles I have been reviewing were developed and in which the spouse who suffered the detriment was under no legal, contractual or statutory obligation to provide the services in question, the Retirees had been required by contract to provide their services. The basis for Confederation Life's "enrichment" in the receipt of those services is the contractual employment relationship. As the subject of a winding-up proceeding — the source of the Retirees' "deprivation" — Confederation Life does not derive any benefit or enrichment from the cessation of the Group Benefits. The fact that a contract cannot be fulfilled does not render the "juristic reason" which it created for the benefit/detriment nugatory.

234 A second juristic reason for the "enrichment" — if such is the case — is the existence of the winding-up proceedings themselves. Policyholders of insurance companies which are undergoing liquidation pursuant to the *Winding-up Act* are entitled to priority over other creditors under para.161(1)(*c*) of that Act. Absent the argument that the Retirees are, themselves, "policyholders" — addressed earlier in these Reasons — the Retirees are not entitled to "jump the queue" in the statutory scheme of things. Such a legislative scheme, in my view, is a "disposition of law", as contemplated by Dickson J. in *Rathwell*, supra, and in *Becker v. Pettkus*, supra, and thus provides a "juristic reason" for the enrichment.

235 Finally, leaving aside the specific statutory scheme of distribution in the *Winding-up Act*, the general insolvency nature of the proceedings is a factor to be considered as part of the "juristic reason" mix. There are insolvency cases in which constructive trusts have been imposed, and, indeed, one such case is *Stanton v. Reliable Printing Ltd.*, supra, involving an employee claim to priority over unsecured creditors for severance benefits. See also *Barnabe v. Touhey*, supra, where Madam Justice Bell fixed a new law firm's accounts receivable with a constructive trust in favour of former partners and at the expense of a secured creditor bank in circumstances where the partners of the new firm were in bankruptcy.

236 However, the fact that the cessation of Group Benefits is the direct result of the insolvency and liquidation proceedings puts the present case on a different footing, in my opinion. All payment and benefit obligations were honoured by Confederation Life right up to the date of the winding-up, August 12, 1994. Deprivation of the Group Benefits did not result from some morally questionable conduct on the part of Confederation Life. The Company simply failed, to the considerable surprise of many people.

237 Where it was not part of the contractual-employment arrangements that the Group Benefit plans would be pre-funded or otherwise secured — as it was not here — insolvency considerations, which in volve the balancing of interests of a number of financially disadvantaged groups, are relevant factors to address. It is not unjust, in such circumstances, for a group such as the Retirees, to be held to the contractual/employment arrangements that have governed the relationship in the pre-insolvency/winding-up regime.

Constructive Trust — Is it the Appropriate Remedy?

238 Even if the facts of this case had survived the "unjust enrichment" analysis, I would not have been inclined to grant the remedy of a constructive trust on that basis, in any event.

239 There is little doubt that a monetary award would be of little assistance to the Retirees in this case. The reason why the proceedings are before this Court in the first place is that there is not enough money to satisfy all of those who have claims against the assets of Confederation Life.

240 However, I am not able to conclude that there is a sufficient connection between the Retirees' contributions of labour, skill and knowledge, on the one hand, and the Company's general assets, on the other hand, to justify the imposition of a constructive trust. Unquestionably, those contributions aided the Company in the conduct of its business — indeed, as the Handbook says, Confederation Life's "good people" are the secret to its success — and in principle such types of contributions *could* form the basis of a proprietary trust (as they did, for instance, in the family law cases); but there is simply nothing in the evidence to indicate either that the Retirees harboured any sort of expectation that they would be obtaining an interest in the Company's assets, or that any such assets would be earmarked to fund and

secure their benefits. The reasonable expectation that the Group Benefits would be provided in partial consideration for their contributions — which the Retirees undoubtedly held — does not equate to an expectation that they would acquire what is tantamount to a proprietary interest in Company assets necessary to ensure their continuance. Similarly, there is nothing in the evidence to establish that Confederation Life harboured any awareness that the Retirees held such expectations. In fact, the evidence is clear that from Confederation Life's standpoint, the Group Benefits were not pre-funded or secured, and could be altered or terminated virtually at any time.

241 Finally, as I stated earlier in these Reasons, it would be inappropriate, in my view, to impose a constructive trust upon the general assets of the Company in order to secure payment of the Group Benefits because in the balancing exercise of weighing the interests of the Retirees against those of the policyholders, in this insolvency and winding-up situation, Parliament has said that the policyholders are to be given priority: the *Winding-up Act*, supra, subs. 161(1).

242 Ms. Rowland argued skilfully on behalf of the Retirees that, in balancing the interests and prejudices to the Retirees and the policyholders, the Court must take into account the reality that the policyholders, as owners of the Company, had elsewhere to look and other sources to which they can look for protection; the Retirees, on the other hand, are limited to their claim against the Company. She pointed out that as owners of the Company, the policyholders had received $120,000,000 in dividends during the year before the collapse, notwithstanding Confederation Life has sustained a loss that year; that they rank ahead of commercial creditors by reason of the *Winding-up Act* priority; and that they have another source, in the form of the Canadian Life and Health Insurance Compensation Corporation, to provide them with at least partial protection. Contrast this, she continues, with the fact that the Retirees have none of these protections and, for the most part, are not in a position to shop around to replace the benefits which they thought were in place for life upon their retirement, and the use of a constructive trust to preserve what the Retirees understood they had all along becomes reasonable.

243 I agree that these factors need to be weighed in the balance, and I have done so. I am not satisfied, in the final analysis, however, that they are sufficient to tip the scales in favour of the Retirees.

244 In summary, then, the Retirees' claim for the imposition of a constructive trust on the basis of unjust enrichment fails, because there is neither the "benefit/detriment" factual basis for such a claim, nor is there an absence of juristic reason for the imbalance between their contributions as employees and the future loss of Group Benefits. Moreover, there is no sufficient connection between the Retirees' contributions as employees and the general assets upon which it is sought to impose a constructive trust, in the sense that the Retirees had no reasonable expectation that the Group Benefits would be pre-funded or secured and, accordingly, that they would be able to look to some portion of Confederation Life's assets in that regard; nor was the Company aware of any such expectation.

(ii) The Supplementary Pensioners

245 For similar reasons, I reject the submission that a constructive trust should be imposed for the benefit of the Supplementary Pensioners.

Enrichment/Detriment

246 I am satisfied that the circumstances relating to the claims of the Supplementary Pensioners do not meet the kind of enrichment-detriment criteria envisaged by the authorities on unjust enrichment canvassed earlier in these Reasons. At the date of the Winding-Up Order, no imbalance of this nature existed and — as is the case with the Retirees' benefits — Confederation Life will not reap any benefit from its financial downfall and inability to continue to fund the supplementary retirement income arrangements on an ongoing basis.

Juristic Reason

247 In any event, there is not an absence of juristic reason for the situation that has arisen. The supplementary retirement income arrangements were put in place to top up the retirement incomes of retiring officers of the Company,

as part of their overall benefit/employment package. Each participant performed their part of the bargain until the Winding-Up situation prevented the Company from doing so. As I have found, in the section of these Reasons dealing with the express trust arguments, it was never intended that the supplementary retirement income arrangements would be secured or pre-funded, but that they would be paid on an ongoing annual basis. While the senior officers who were the beneficiaries of these arrangements certainly had the expectation that their supplementary income payments would be forthcoming, as agreed, I am not able to find on these materials that they had any reasonable expectation that those benefits would be pre-funded or otherwise secured. Indeed, with respect to the most active officers, such as Mr. Burns and Mr. Cunningham, the conclusion is inescapable that they knew very well the exact opposite was the case.

248 The conclusion to which I am led, therefore, is that the supplementary retirement income arrangements, as they existed at the date of the Winding-Up Order, reflected the pay-as-you-go retiring allowance initially authorized — and the only arrangement duly authorized — by the Board of Directors. Lack of pre-funding did not constitute a failure by Confederation Life to comply with its undertaking to its employees, although its inability to continue to fund the benefits as they occur, to be sure, does. In short, it is the financial collapse of Confederation Life which has led to the unfortunate situation in which the supplementary retirement income benefits are not being paid, not the absence of any legal or equitable basis — or "juristic reason" — for the situation that has arisen.

Constructive Trust — Is it the Appropriate Remedy?

249 Moreover, even if the requisite criteria for the establishment of an "unjust enrichment" did exist, I would not impose a constructive trust as a remedy in favour of the Supplementary Pensioners. My reasons are similar to those relating to the same point regarding the Retirees. There is not a sufficient link between the benefit/detriment alleged and the property which it is sought to impress with the trust — the general assets of Confederation Life. Nor would it be an equitable balancing of the interests, particularly given the statutory scheme favouring policyholders in insurance company collapses.

250 As important as they are to the recipients involved, ample retirement benefits for senior officers and employees remain benefits that accrue to those who are closely connected to the operations of the Company, and they are not necessarily always in the interests of those for whom the operations of the Company are carried out, namely the shareholders — or, in this case, the policyholders. As the Towers Perrin Report of September 14, 1992 — which was commissioned to suggest ways of providing secured funding for supplementary retirement benefits — noted [emphasis added]:

> But, as you know, there are no laws to give [supplementary non-registered retirement income arrangements for executives] (SRIA's) security *and few companies fund them*. Companies plan to make monthly benefit payments directly to the executives from operating revenues.
>
> Generally, executives do not care where their benefits come from — if they get them. But they may worry about what will happen if the company is unable or is unwilling to make the payments. Those concerns usually focus on the possibility of:
>
> • a change of control of the corporation;
>
> • the bankruptcy of the corporation; and/or
>
> • a future decision to renege on the promises that have been made to them.
>
> If such concerns are high, executives seek external "funding" to increase their feeling of security. Unlike the case for registered plans, such funding almost invariably increases the cost of providing the benefits. *From the shareholders' perspective those costs can rarely be justified unless funding is necessary to attract, retain and motivate key executives.* To date, funding has not been that critical.

> So most companies decide not to fund the SRIA benefits unless/until there is a specific, imminent security concern (e.g., the company is "in play" or on the brink of bankruptcy). ...

251 Apart from confirming that Confederation Life's supplementary retirement income arrangements were not pre-funded, the foregoing passage illustrates that the Company was not only not an exception, it was in the mainstream in this respect. To restructure this situation, in circumstances in which to impress the general assets of the Company with a trust sufficient to fund the benefits fully — thereby favouring the corporate officers over the statutorily preferred policyholders — would be an inappropriate use of the Court's power to impose a constructive trust, in my view.

(iii) The Deferred Compensation Claimants

252 Precisely the same analysis applies with respect to the Deferred Compensation Claimants, as applies with respect to the Retirees and the Supplementary Pensioners. I will not repeat it here, except to say the "equities" apply with even greater force in not favouring the two most senior and responsible officers of the Company over the interests of the policyholders.

IV. The Court's Power to Impose Duties upon a Liquidator under s. 33 of the Winding-up Act

253 Section 33 of the *Winding-up Act* reads as follows [emphasis added]:

> 33. A liquidator, on his appointment, shall take into his custody or under his control all the property, effects and choses in action to which the company is or appears to be entitled, *and shall perform such duties with reference to winding-up the business of the company as are imposed by the court* or by this Act.

254 Counsel for the Retirees submitted the Court should exercise its powers under the latter part of that section and direct the Provisional Liquidator to continue to fund the Group Benefits at least during the duration of the winding-up and to take action against those responsible for the funding of the Group Benefits. This argument was based upon the premise, however, that Confederation Life was in breach of fiduciary and/or trust obligations owing to the Retirees. As I have concluded that no such obligations existed, the argument loses its force.

V. Other Issues with Respect to the Supplementary Pensioners

255

(1) Is There a Distinction between the Supplementary Pensioners "In Pay" and Those "Not In Pay"?

256 As indicated earlier in these Reasons, there are 11 eligible former employees who were already receiving payments under the supplementary retirement income arrangements at the time of the Winding-Up Order, and 20 who were eligible but who had not yet commenced to receive their payments. Although none of the counsel who opposed the position of the Supplementary Pensioners advanced the submission that the two groups should be treated separately, they were nonetheless represented by separate counsel. As Mr. Robertson, who was appointed to represent those "Not in Pay" put it, there was some concern that an argument might be made that a difference existed because of a difference in "vesting" rights between the two groups.

257 Mr. Robertson submitted that there was no such difference, and I agree. To the extent that "vesting" is an issue in these proceedings, I am satisfied that a Supplementary Pensioner in these circumstances has the same vested rights with respect to their entitlement whether they were actually in receipt of benefits at the time of the Winding-Up Order or they were not.

258 I draw no distinction between the two groups for the purposes of my decision and these Reasons.

(2) The "Pension" Issues Respecting the Supplementary Retirement Income Arrangements

259 The *Pension Benefits Act*, supra, applies to every "pension plan" that is provided for persons in Ontario, and requires that every "pension plan" be registered with the Superintendent of Pensions: ss. 3 and 6.

260 Counsel for the Supplementary Pensioners "In Pay" and for those "Not in Pay" submit that Confederation Life's supplementary retirement income arrangements with its employees constitute a pension plan to which the *Pension Benefits Act*, supra, applies. Therefore, they argue, they attract the pre-funding requirements of s. 55 and the deemed statutory trust and statutory lien and charge of s. 57, all as articulated in the questions set out in the section of these Reasons entitled "Directions Sought and Issues".

(a) Is Confederation Life's Supplementary Retirement Income Arrangement a "Pension Plan" within the Meaning of the Pension Benefits Act?

261 The purpose of Confederation Life's supplementary retirement income arrangements is to "top up" the retirement income of senior corporate executives to that which it would otherwise have been under the Registered Pension Plan were it not for the Revenue Canada limits on payments out of such plans, based upon the employee's full salary and service. In general terms, the formula for determining what amount a retiring officer will receive is the difference between

a) what would otherwise be payable under the registered plan, were it not for the Revenue Canada limits and

b) the pension amount actually payable under the provisions of the registered plan.

262 The target range for the total package appears to have been 4% of final average earnings multiplied by a person's years of service.

263 I am satisfied, in spite of the "supplementary pension" nomenclature attributed to them by those involved — particularly in later years — that these arrangements are not "pension plans" as envisaged by the *Pension Benefits Act*, supra. There are two main reasons for this conclusion. In the first place, the supplementary retirement income arrangements, in my view, are precisely what they were initially — and only — authorized to be, namely "retiring allowances consistent with the service and contribution by [the member] to the Company as authorized by the Board of Directors". As such, they are specifically excluded from the purview of the *Pension Benefits Act*, supra, by virtue of the definition of a "pension plan" in s. 1 of the Act. In the second place, the arrangements do not constitute a "pension plan", as that term is contemplated in the *Pension Benefits Act*, supra, because they do not constitute a "plan *organized and administered to provide pensions* to employees" as required by the Act.

The Arrangements as "Retiring Allowances"

264 "Retiring allowances" are specifically excluded from "pension plans" which are defined in s. 1 of the *Pension Benefits Act*, supra, as follows:

> "pension plan" means a plan organized and administered to provide pensions for employees, but does not include,
>
> . . . . .
>
> (*b*) a plan to provide a retiring allowance as defined in subsection 248(1) of the *Income Tax Act* (Canada),

265 The initial consideration of "the matter of the Company providing a supplementary pension to those officers who might be retiring and whose pensions would be limited by existing maximums" is reflected in the Minutes of the meeting of the Board of Directors of June 21, 1972. Under the heading "Pensions — Supplementary" the foregoing was noted, and the Minutes continued [emphasis added]:

> It was deemed to be in the best interests of the Company to provide a supplemental pension to such participants and the concept of so doing was approved in principle. *It was agreed, however, that Management should be requested to investigate the method of handling the matter, possibly by way of an employment agreement*.

266 Not until three years later did the Board deal with the matter again. On July 16, 1975 it passed the only existing resolution authorizing such a scheme. In spite of the use of the words "supplemental pension" and the heading "Pensions — Supplementary" in the earlier resolution, the July 16, 1975 Resolution stated [emphasis added]:

> THAT WHEREAS it is the intention of Confederation Life Insurance Company to recognize the valuable, loyal and devoted service of the Senior Officers of the Company, Be It Resolved that *on retirement there be provided a retiring allowance* consistent with the service and contribution by such members to the Company as authorized by the Board of Directors.

267 It is acknowledged that this is the sole corporate resolution on Confederation Life's part which authorizes the payment of additional retirement income benefits to employees. There is no formal plan document which sets out a supplementary pension plan for the senior officers. Throughout the 1980's — with infrequent exceptions — the concept of the topping up payments is referred to consistently in corporate memoranda and records as the "retiring allowance", the "supplementary retiring allowance" or the "retirement allowance". Mr. Cunningham was the author or recipient of numerous documents containing such references. When, in his affidavit, he defines the "arrangement to supplement the pension benefits received under the [Company's registered pension plan]" established "in accordance with" the June 21, 1972 and July 16, 1975 Board resolutions as "the *Supplementary Plan*", he could only have been referring, therefore, to the retiring allowance arrangement authorized in the July 16, 1975 resolution.

268 This is confirmed by the April 1983 Letters which Mr. Cunningham says were sent to each of the eligible senior officers, on the instructions of Mr. Burns, "briefly describ[ing] the Plan and its operations". Those Letters state that the Company agrees to provide the retiring officer with "*a retiring allowance* payable monthly commencing on the 28th day of the month following [the officer's] retirement". The Company agrees to do so "in recognition of [the officer's] valuable, loyal and long devoted service" and recites that it is being done "in accordance with a resolution of the Board of Directors". There is only one such resolution, namely, that of July 16, 1975 authorizing the provision of a retiring allowance.

269 The concept of a "retiring allowance" is defined in the *Income Tax Act* (Canada), s. 248(1) as follows:

> "retiring allowance" means an amount (other than a superannuation or pension benefit ...) received
>
> > (*a*) upon or after retirement of a taxpayer from an office or employment in recognition of his long service ...
>
> . . . . .
>
> by the taxpayer or, after his death, by a dependant or a relation of the taxpayer or by the legal representative of the taxpayer.

270 Both the Board resolution of July 16, 1975 and the April 1983 Letters reflect these concepts — a payment to be received upon retirement in recognition of service to the employer.

271 I note that "retiring allowance" excludes an amount received as a "pension benefit". The definition of "pension plan" in the PBA, as I have recited earlier, excludes "a plan to provide a retiring allowance" as defined in the *Income Tax Act* (Canada). This suggests to me that a given vehicle for the provision of supplementary retirement income to an officer or employee may have the appearance of both a retiring allowance and a pension benefit, but that if it is designed to be a "retiring allowance" it is not considered to be a "pension benefit", and vice versa. What, then, is a "pension benefit"?

272 The PBA, s. 1, includes the following definitions:

> "pension" means a pension benefit that is in payment;
>
> "pension benefit" means the aggregate monthly, annual or other periodic amounts payable to a member ... during the lifetime of the member ... to which the member ... will become entitled under the pension plan ...

273 In short, a pension benefit is simply the total amount payable to an employee upon retirement under a pension plan. And a "pension plan", as observed earlier, is "a plan organized and administered to provide pensions for employees". The word "plan" itself is a vague and elastic concept. It can be made to apply to a wide range of circumstances, and how wide that range may be depends upon how broad a definition one might choose to adopt. Do the facts demonstrate "a scheme of action, project, design, the way in which it is proposed to carry out some proceeding", as broadly articulated by the *Shorter Oxford English Dictionary*; or "a formulated and especially detailed method by which a thing is to be done", as more precisely defined in the *Concise Oxford Dictionary*?

274 Leaving aside for the moment the question of whether the Confederation Life arrangements are something which are "organized and administered" to provide pensions, and assuming that they constitute a "plan" of some sort, it appears to me that they are capable of filling the description of either a plan to provide a pension benefit or a plan to provide a retiring allowance. They call for the payment of periodic amounts during the lifetime of the recipient, to which the recipient will become entitled under the arrangement (a "pension benefit": PBA, s. 1). They envisage the payment of an amount received upon or after retirement from an office or employment in recognition of the recipient's long service (a "retiring allowance": *Income Tax Act* (Canada), s. 248(1)).

275 In such circumstances, it only makes sense to characterize the arrangement in the manner in which it was authorized and characterized by the Company itself, in the constating resolution, and in the initial documentation and correspondence with the Retirees. What was created was a plan to provide a "retiring allowance". The retiring allowance is designed to provide supplemental retirement income for senior officers of the Company, to which it is offered in order to "top up" the maximum retirement payments permissible under the Company's Registered Pension Plan.

276 As late as March 8, 1988, this was still recognized by Mr. Cunningham. In a memorandum bearing that date he wrote to Mr. Pitts, the Vice-President of Group Pensions [emphasis added]:

> Our Board of Directors have previously approved by resolution that *specific individuals as reported by management* to the Board Salary committee will be *entitled to receive an additional retirement allowance benefit*. The Company has defined that those eligible in Canada will be the senior officers of the Company.
>
> *The retirement allowance benefit* is the amount in excess of the government maximum calculated *on the same formula as the salaried pension plan* for the retirement, death or termination benefit.
>
> We have initiated a full review of the current administration of the retirement allowance benefit, ie. Board Resolution, group policy, in dividual certificates, and annual employee statements. We expect to be in a position to recommend revisions to Pat Burns in the fall. In the meantime, I wanted to assure you of your eligibility and the basic form of the benefit that you would be entitled [to].

277 While the review mentioned was initiated in the ensuing years, and some recommended revisions were proposed, no Board resolutions were ever passed changing the nature of the supplementary retirement income arrangements as established by the July 16, 1975 Board Resolution and as described in the April 1983 Letters and Mr. Cunningham's memorandum of March 8, 1988.

278 Beginning in the early 1990's, however, the nomenclature changed. References to "retiring allowances" became less frequent and references to such things as "supplementary pension arrangements", the "Sr. Officers' Supplementary Pension arrangement", "the Company supplementary plan for senior officers" and the "Supplementary Pension Plan" became common in corporate memoranda and documentation relating to such retirement benefits. Indeed, there are at least five offers of employment, on the basis of which individuals apparently joined the Company, in which reference is made to "the Supplementary Pension" or the "Supplementary Pension Plan".

279 I observe that there is some coincidence between the timing of this general change in nomenclature and the creation of the Board of Directors' sub-committee known as the Human Resources and Compensation Committee — of which

Mr. Cunningham was the Chair — and the involvement of Towers Perrin in studying the Company's supplementary retirement income arrangement. Whether these circumstances account for the change in terminology or not, I do not think that the change in nomenclature itself can alter the nature of what it was that Confederation Life was agreeing to provide to its senior officers, in the absence of a new corporate form of authorization. No such new corporate form of authorization — either in the form of a different resolution of the Board of Directors, or in the form of some other re-defined "plan" duly approved by the Company — exists.

280 In June 1993 Mr. Cunningham sent the second form letter to senior officers of Confederation Life entitled to the supplementary retirement income benefit. Its contents are outlined in some detail earlier in these Reasons. Mr. Cunningham deposes that in or about 1992, upon a review of the supplementary pension arrangements by the Corporate Human Resources Department, he became concerned about the documentation describing the benefits which were to be received. He was also concerned that details of the benefits be communicated to the more recently eligible senior officers. Consequently, "in order *to clarify the terms* of the Supplementary Plan (as his af fidavit had defined the plan for a retiring allowance authorized in the July 16, 1975 Board resolution)", he sent a letter "*restating its terms* to each eligible member". I will recapitulate a portion of that letter here for sake of convenience [emphasis added]:

> The purpose of this letter is to clarify and confirm your entitlement to the Senior Officers' Supplementary Pension *arrangement*.
>
> *In accordance with a resolution of the Board of Directors* and in order to ensure that your post retirement income compares equitably to other employee members of the registered Pension Plan for Salaried Employees, when measured as a percentage of pre-retirement income, *the Company agrees to provide you with a Supplementary Pension on your retirement*. This supplement will be in addition to the pension benefit you will receive from the registered pension plan and recognizes that the amount of pension benefit which can be provided under the provisions of the registered Plan is limited by Revenue Canada regulations.

281 The core authority for the proposal, therefore, as stated, is "a resolution of the Board of Directors". Only one such resolution exists — that of July 16, 1975, authorizing a retiring allowance. Moreover, neither the June 1993 Letter itself, nor Mr. Cunningham's explanation of it, purports *to change* the arrangement as previously established; they merely purport *to clarify and confirm* it. While the Letter goes on to outline a tie-in between the supplementary retirement income arrangement and the Registered Pension Plan, in terms of the formula for payment and the escalation of any benefits, these factors alone cannot operate to incorporate the terms of the Registered Pension Plan into the supplementary retirement income arrangements and thus turn them into a pension plan, in my view — which is the effect of what counsel submit should be the case. The supplementary retirement income arrangement is a "top up" arrangement. It is designed to fit with the income flow from the Registered Pension Plan to supply the retired senior officers with an income stream in retirement that "compares equitably to other employee members of the registered [plan] ... when measured as a percentage of pre-retirement income". It stands to reason that the payment of the two amounts might be intertwined and that the benefits would advance together, in order to give effect to this objective.

282 Moreover, it seems to me, the argument that the terms and provisions of the Registered Pension Plan are engrafted upon the supplementary arrangements would defeat the very purpose of the top up principle. What it would mean is that the Registered Pension Plan and the supplementary arrangements would be so intertwined that they would become, in effect, one — the registered one — and the Revenue Canada limits would then apply to limit payments out to the recipients!

283 What, though, of the senior officers who received letters describing the supplementary retirement income benefit as a "supplementary pension" arrangement or plan; and, indeed, what of those who accepted employment on the basis that they would be the recipient of such a benefit? Is the Company entitled to resile from a position which it appears to have held out to them, through officers with the apparent authority to do so, that they had supplementary pension benefits? It seems to me that the answer to such questions is this: however the benefit is described to the recipients, they

could not reasonably have expected to receive anything other than whatever it was that the Company provided under the description "supplementary pension arrangement" or "supplementary pension plan" or one of their derivatives.

284 If in fact, what was being provided was not a "pension plan" but some other form of retirement income vehicle, referring to it as a pension plan cannot make it such. It may give the recipient some form of claim against the authors of the correspondence and the Company, on the basis of misrepresentation or some other related cause of action. It may be that the misrepresentation is a relevant factor for consideration in assessing the appropriateness of other remedies — such as the imposition of a constructive trust, for example, which I have dealt with elsewhere. But the misdescription cannot operate to transmogrify something that is not a pension plan into a pension plan. A leopard does not change its spots and become a cougar simply by calling it a cougar, despite the fact there may be some similarities between the two species.

Not a Plan "Organized and Administered" to Provide Pensions

285 There is another reason why, in my opinion, the Confederation Life supplementary retirement income arrangements do not constitute a "pension plan" within the meaning of the *Pension Benefits Act*, supra. On the facts of this case, they simply do not fit what is contemplated as a pension plan in the legislation. If the arrangements constitute a "plan" at all, they are not a plan "*organized and administered to provide pensions*".

286 In construing legislation a Court must look, so far as possible, to the plain wording and meaning of the language used, and do so in the context of the legislation as a whole: *Driedger on the Construction of Statutes*, 3rd ed., Ruth Sullivan, ed., (Toronto: Butterworths, 1994) at pp. 3-7. Earlier I referred to the vagueness in meaning of the word "plan". Even if one accepts the broader and more general approach of the *Shorter Oxford English Dictionary*, however — "plan" as a "scheme of action, project, design, *the way in which it is proposed to carry out some proceeding*" — it is plain that the Legislature intended to give the word a more restricted meaning. It is not just any "plan" which makes a "pension plan". It is a plan that is *organized*. It is a plan that is *administered*. It is a plan that is organized and administered *to provide pensions*. This leads me to conclude that the Legislature intended a pension plan to be something more in line with the *Concise Oxford* definition of "plan", i.e., "plan" as "*a formulated and especially detailed method* by which a thing is to be done."

287 Some indication of what the Legislature had in mind by a plan "organized and administered to provide pensions" is to be found in the provisions of subs.10(1) of the *Pension Benefits Act*, supra. There the statute stipulates what must be set out in the documents that create and support a pension plan. The criteria include:

1. The method of appointment and the details of appointment of the administrator of the pension plan.

2. The conditions for membership in the pension plan.

3. The benefits and rights that are to accrue upon termination of employment, termination of membership, retirement or death.

4. The normal retirement date under the pension plan.

5. The requirement for entitlement under the pension plan to any pension benefit or ancillary benefit.

6. The contributions or the method of calculating the contributions required by the pension plan.

7. The method of determining the benefits payable under the pension plan.

8. The method of calculating interest to be credited to contributions under the pension plan.

9. The mechanism for payment of the cost of administration of the pension plan and pension fund.

10. The mechanism for establishing and maintaining the pension fund.

11. The treatment of surplus during the continuation of the pension plan and on the wind up of the pension plan.

12. The obligation of the administrator to provide members with information and documents required to be disclosed under this Act and the regulations.

13. The method of allocation of the assets of the pension plan on windup [sic].

14. Particulars of any predecessor pension plan under which members of the pension plan may be entitled to pension benefits.

15. Any other prescribed information related to the pension plan or pension fund or both.

288 With the exception of a nod in the direction of items numbered 3 and 7 above, and possibly item number 4, the Confederation Life arrangements do not feature any of these characteristics. There is no formal plan document setting out the terms and benefits of the arrangement. In fact, there appears to have been a number of different arrangements. This explains why I have been using the plural "arrangement*s*" in describing this benefit throughout these Reasons. In spite of the April 1983 Letters and the June 1993 Letter, an examination of the correspondence gathered together by counsel for the Provisional Liquidator in vol. 36 or the Record reveals that the use of terminology and the expressed terms of the arrangements vary from senior officer to senior officer. Mr. Zarnett advised that this collection represents the highest documentary claim for each individual.

289 I am asked not to deal with the Supplementary Pensioners on an individual basis, and indeed the evidence is not adequate to enable me to do so. However, a review of the documentation gathered together in vol. 36 is instructive, I think, in assessing whether the treatment of this retirement benefit is a plan "organized and administered to provide pensions".

290 Eight of the 11 Supplementary Pensioners "In Pay" received the April 1983 form letter stipulating the provision of a retiring allowance, or an identical letter or one *similar to it*. Even the letter to Mr. Pitt, which was dated January 13, 1992 — during the period when references to "supplementary pension arrangements" and nomenclature of that sort were more common — is framed in terms of a retiring allowance. Two of these Claimants received the June 1993 Letter or a similar one (one such Claimant had also received a 1983 letter) and two received individualized packages referring to "supplementary pensions" in one form or another.

291 Of the 20 Supplementary Pensioners "Not in Pay", 8 received the June 1993 Letter or something similar to it. Twelve received individual packages, 3 of which related to termination or pre-emptive parachute situations and 5 of which were the subject matter of offers of employment with the Company. The nomenclature in these packages and in the June 1993 set of letters is in terms of "supplementary pension arrangements" or related language.

292 Keeping in mind Mr. Cunningham's evidence that all eligible senior officers received either the April 1983 Letters or the June 1993 Letter — and some, presumably, both — the added layers of

293 "similar" letters and individual arrangements and the lack of many of the indicia of a pension plan as laid out in subs. 10(1) of the *Pension Benefits Act*, supra, all lend credence to the view that what was presented to the senior officers of Confederation Life was not a "pension plan" but a more general plan to provide retiring allowances in their individual cases.

294 I conclude, therefore, that the supplementary retirement income arrangements which Confederation Life agreed to provide to its senior officers do not constitute a "pension plan" to which the *Pension Benefits Act*, supra, applies.

(b) Regulation 909, as Amended

295 The Regulations under the *Pension Benefits Act*, supra, exempt certain pension plans from the application of the Act and regulations. In October 1994 — 2 months after the Winding-Up Order — subs. 47(3) of Reg. 909 was amended to add the following exemptions:

> 5. A retirement compensation arrangement as defined in subsection 248(1) of the *Income Tax Act* (Canada).
>
> 6. A plan that provides only benefits that exceed the maximum benefit limits applicable to a pension plan that is registered under the *Income Tax Act* (Canada).
>
> 7. A plan that permits only contributions that are in excess of the maximum contribution limit applicable to a pension plan that is registered under the *Income Tax Act* (Canada).

296 It was submitted that this amendment makes it clear that the type of arrangements in place at Confederation Life for supplementary retirement compensation are not caught by the PBA. The counter argument was that the amendment does not apply because it postdates the Winding-Up Order and cannot be given retrospective effect. In view of my conclusion, on the other grounds, that the arrangements do not constitute a pension plan, and therefore are not governed by the provisions of the Act, it is not necessary to decide whether the Regulation does or does not apply. I would have been reluctant, however, to interpret the amended Regulation in a manner that would give it retrospective effect in view of the general rule against attributing a retroactive and retrospective effect to legislation unless such a construction is expressly or by necessary implication required by the language of the legislation in question: see, *Gustavson Drilling (1964) Ltd. v. Minister of National Revenue*, 66 D.L.R. (3d) 449, at p. 460, [1975] 1 S.C.R. 271, at p. 279, per Dickson J.; L.P. Pigeon, *Drafting and Interpreting Legislation* (Toronto: Carswell, 1988) at pp. 75-76.

297 I am satisfied that the amendment to Reg. 909 as of October 28, 1994 is of neutral impact in the determination of the issues before me.

(c) The Deemed Statutory Trust and Lien of s. 57 of the Pension Benefits Act

298 There are a number of other pension-related issues that were raised and dealt with in argument.

299 Two such related issues are the twin questions of whether — assumingthe *Pension Benefits Act*, supra, applies to the arrangements — Confederation Life is deemed to hold in trust an amount equal to the due but unpaid contributions required under the legislation and regulations and therefore whether the assets of the Company are subject to a lien and charge in such an amount? These requirements, which are to be found in subss.57(3) and (5) of the Act, are generally referred to as the deemed statutory trust and lien provisions. Since I have concluded that the supplementary retirement income arrangements in place at Confederation Life are not a "pension plan" within the meaning of the PBA, it is not necessary to address these issues at length.

300 If the arrangements did constitute a pension plan within the meaning of the PBA, however, Confederation Life's promise to pay the supplementary pension benefits — as the Ontario Court of Appeal had noted in *Re St. Marys Paper Inc.* (1994), 19 O.R. (3d) 163, at p. 168 — would be "a promise which is subject to the carefully calibrated regulatory scheme set out in the PBA and its regulations". It would be subject to the minimum standards set out in the Act, including the minimum funding requirements of s. 55(1). In *Re St. Marys Paper*, Justices Arbour and Osborne stated (at p. 173) [emphasis added]:

> The PBA and regulations impose an obligation on an "employer"[1] to ensure that a pension plan is adequately funded, both on an ongoing basis and on a wind-up of the plan. *This obligation exists quite apart from the particular funding requirements set out in the pension plan itself. This obligation is central to the regulatory scheme established by the PBA*. The Act requires that its minimum funding standards be met.

Consequently, if the Confederation Life supplementary retirement income arrangements were governed by the "carefully calibrated regulatory scheme set out in the PBA", it would follow, in my view, that the deemed statutory trust and the deemed statutory charge and lien of subss.57(3) and (5) would be operative. I think arguments to the effect that the Company, in the particular circumstances of the Confederation Life arrangements, is not an employer required to make contributions to a pension plan cannot prevail in view of the law as articulated in *Re St. Marys Paper Inc.*, supra.

(d) The Constitutional Issue

301 If the provisions of the PBA governed the Confederation Life arrangement and the deemed trust and statutory lien provisions of the Act therefore applied, I would be confronted with the constitutional issue that has been argued. In as much as I have concluded that neither of these eventualities is the case, in the circumstances here, I do not intend to comment upon the interesting and difficult question of whether there would be such an active conflict between the operation of s. 57 of the PBA and the priority scheme of s. 161 of the *Winding-up Act*, supra, to cause the doctrine of paramountcy to be invoked: see *Multiple Access Ltd. v. McCutcheon*, [1982] 2 S.C.R. 161, at p. 191. It is an accepted principle of constitutional adjudication that a Court should avoid determining a constitutional question unless it is necessary to do so in order to decide the matter before it: see, for example, *Tremblay c. Daigle*, [1989] 2 S.C.R. 530, at pp. 571-572. In this case it is not necessary to do so.

Part F: Conclusion

302 For all of the foregoing reasons, then, the questions posed by the Provisional Liquidator for advice and directions will be answered as follows:

1) The Claimants have claims against the estate of Confederation Life Insurance Company. They are claims, however, as ordinary creditors or, at least, claims which rank behind those of Confederation Life's policyholders under para. 161(1)(*c*) of the *Winding-up Act*, supra, (except to the extent that any may be entitled to the preferred status of employee claims under s. 72 of that Act, about which there was no evidence).

2) None of the Claimants is entitled to succeed on the basis either that their claim constitutes an express trust or that their claim should attract the imposition of a constructive trust.

3) None of the Claimants is entitled to succeed on the basis that their claim is a claim under a policy in respect of which priority is accorded to a policyholder by the provisions of para. 161(1)(*c*) of the *Winding-up Act*, supra.

4) Specifically, with respect to the claims of the Supplementary Pensioners, the claim to a supplementary retirement income benefit does not constitute a "pension plan" to which the *Pension Benefits Act*, supra, applies.

303 I was asked to answer the Provisional Liquidator's questions posed with respect to the Supplementary Pensioners Not in Pay in keeping with the following alternative assumptions:

(i) Assume, without deciding, that the making of the Winding-Up Order terminated the employment of all members of the class whose employment was not previously terminated; and,

(ii) Assume, without deciding, that the making of the Winding-Up Order did not terminate the employment of any member of the class who was on August 11, 1994, an employee of Confederation Life Insurance Company.

304 My conclusions with respect to the supplementary retirement income arrangements do not vary with whether the recipients are "In Pay" or "Not in Pay", nor with whether the recipients are deemed to have been terminated by virtue of the Winding-Up Order. Accordingly, it is not necessary to address these alternative assumptions further.

305 All parties are entitled to their costs out of the estate. I may be spoken to with regard to the scale of those costs, and I am prepared to fix them if counsel cannot agree.

306 In conclusion, I would like to express my appreciation to all counsel for their thorough, skilful and helpful assistance in dealing with these difficult questions.

Order accordingly.

APPENDIX "B"

The following are the classes of Claimants:

(i) *Retirees* of Confederation Life and their spouses and dependent children (the "Retirees") for the continued payment of their major medical, dental, and group life insurance;

(ii)

(I) "*Supplementary Pensioners In Pay*", i.e., former employees of Confederation Life claiming payment of supplementary pension benefits in accordance with the supplementary pension arrangement of Confederation Life, and who were receiving such payments as at the date of the Winding-Up Order but whose payments were subsequently terminated by the Liquidator (or, where such former employees are deceased, the persons claiming under them);

(II) "*Supplementary Pensioners Not in Pay*", i.e., former employees of Confederation Life claiming payment of supplementary pension benefits in accordance with the supplementary pension arrangement of Confederation Life, and who had not commenced receiving payments as at the date of the Winding-Up Order (or, where such former employees are deceased, the persons claiming under them); and,

(iii) *the former Chairman of the Board of Directors and the former President of Confederation Life for the payment of deferred compensation* pursuant to the deferred compensation plan of Confederation Life.

Footnotes

1 The issue in the case was whether the appellant, a trustee in bankruptcy, was an "employer" within the meaning of the PBA.

35

2014 ABQB 520
Alberta Court of Queen's Bench

Wurth v. 1135096 Alberta Ltd. (Trustee of)

2014 CarswellAlta 1489, 2014 ABQB 520, [2014] A.W.L.D. 4267, 244 A.C.W.S. (3d) 520, 596 A.R. 1

Larry Wurth, Applicant and MNP Ltd., Trustee of the Estate of 1135096 Alberta Ltd., Respondent

J. Strekaf J.

Heard: July 23, 2014
Judgment: August 20, 2014
Docket: Calgary BK01-094159

Counsel: Peter R.S. Leveque, for Applicant
Peter Jull, Q.C., for Trustee

Subject: Estates and Trusts; Insolvency

Headnote

Bankruptcy and insolvency --- Proving claim — Disallowance of claim — Appeal from disallowance — General principles

Claimant claimed property interest in funds in bankrupt's estate that he alleged were paid to bankrupt by related company in breach of trust — Trustee disallowed claimant's proof of claim — Claimant appealed — Appeal dismissed — Claimant established that company was in knowing receipt of funds transfered in breach of trust — However, claimant not entitled to tracing remedy or constructive trust that would give him proprietary interest in funds — Moneys paid by company to bankrupt could not be traced to any specific assets acquired by bankrupt — Claimant could not identify specific property which was subject of enrichment and was essentially seeking equivalent of floating charge over all of company's assets — Juristic reason for deprivation was operation of Bankruptcy and Insolvency Act — Claim brought too late — If constructive trust granted, bankrupt's other creditors would be deterimentally affected.

Table of Authorities

Cases considered by *J. Strekaf J.*:

Barnabe v. Touhey (1995), 1995 CarswellOnt 1167, 10 E.T.R. (2d) 68, 37 C.B.R. (3d) 73, 26 O.R. (3d) 477 (Ont. C.A.) — followed

Bassano Growers Ltd. v. Price Waterhouse Ltd. (1997), *(*sub nom. *Bassano Growers Ltd. v. Diamond S Produce Ltd. (Bankrupt))* 214 A.R. 380, 6 C.B.R. (4th) 188, 1997 CarswellAlta 1182 (Alta. Q.B.) — followed

Bassano Growers Ltd. v. Price Waterhouse Ltd. (1998), 1998 CarswellAlta 555, *(*sub nom. *Bassano Growers Ltd. v. Diamond S Produce Ltd. (Bankrupt))* 216 A.R. 328, *(*sub nom. *Bassano Growers Ltd. v. Diamond S Produce Ltd. (Bankrupt))* 175 W.A.C. 328, 66 Alta. L.R. (3d) 296, 6 C.B.R. (4th) 199, 1998 ABCA 198 (Alta. C.A.) — referred to

Citadel General Assurance Co. v. Lloyds Bank Canada (1997), 152 D.L.R. (4th) 411, 1997 CarswellAlta 823, 1997 CarswellAlta 824, [1997] 3 S.C.R. 805, 66 Alta. L.R. (3d) 241, [1999] 4 W.W.R. 135, 19 E.T.R. (2d) 93, *(*sub nom. *Citadel General Life Assurance Co. v. Lloyds Bank Canada)* 206 A.R. 321, *(*sub nom. *Citadel General Life Assurance Co. v. Lloyds Bank Canada)* 156 W.A.C. 321, 219 N.R. 323, 47 C.C.L.I. (2d) 153, 35 B.L.R. (2d) 153 (S.C.C.) — considered

Statutes considered:

Bankruptcy and Insolvency Act, R.S.C. 1985, c. B-3
Generally — referred to

s. 67(1)(a) — considered

s. 81(1) — considered

s. 81(2) — considered

s. 81(3) — considered

APPEAL by claimant from disallowance of proof of claim by trustee in bankruptcy.

***J. Strekaf J.*:**

Introduction

1 Larry Wurth is appealing the decision of the MNP Ltd. ("MNP"), in its capacity as Trustee in Bankruptcy of 1135096 Alberta Ltd ("113"), pursuant to section 81(2) of the *Bankruptcy and Insolvency Act*, R.S.C. 1985, c. B — 3, as amended ("*BIA*") to disallow the Proof of Claim he had filed in relation to a property interest in $154,404 of the funds in the approximate amount of $344,000 remaining in the bankrupt's estate. He claims that monies were paid to 113 by a related company in breach of trust, that 113 acquired the monies with knowledge of the breach of trust, and that as a result he is entitled to a constructive trust with respect to those funds. The Trustee opposes the appeal.

Relevant Facts

2 The evidence on this appeal consists of two affidavits of Mr. Wurth, upon which he was not cross-examined, as well as the Trustee's Report and Supplemental Report, from which evidence I make the following factual findings.

3 In May 2008 Mr. Wurth was approached by Brian Ostrander to invest in a hotel project in Fort Saskatchewan, Alberta to be undertaken through 1264271 Alberta Ltd ("126"), a company of which Mr. Ostrander was the sole director that was wholly owned by a company of which he was also the sole director. Mr. Ostrander is also one of the directors and a 30% shareholder in 113.

4 Mr. Wurth provided a deposit of $480,823.43 to 126 on June 10, 2008, which he deposes was to be held in trust pending his review of documentation ("Wurth Funds"). This characterization is consistent with how Mr. Wurth described the payment in subsequent correspondence with Mr. Ostrander and there is no evidence contradicting same. I accept that the money was provided pursuant to an oral agreement that it would be held in trust.

5 Contrary to the oral arrangement, the Wurth Funds were not held in trust but were wholly expended by 126 by July 31, 2008. Between June 30, 2008 and July 31, 2008, $111,000 was paid to 113, whose business involved the construction and operation of a hotel in Strathmore, Alberta. 113 used all of the funds it received from 126 during this period by July 31, 2008 for such things as their overdraft (approx. $28,000), bank loan payments (approx. $35,000), property tax (approx. $20,000), employee expenses (approx. $16,000), franchise fees, visa expenses, waste disposal services and bank

fees. In addition, 126 paid $50,000 directly to one of 113's third party subcontractors with respect to work performed on the construction of the Strathmore hotel, of which $43,404 came from the Wurth Funds. The remainder of the Wurth Funds were paid by 126 to other parties.

6 Mr. Wurth began demanding the return of his deposit from Mr. Ostrander and 126 in February 2009, and commenced an action against Mr. Ostrander, 126 and others on April 30, 2010 to recover same.

7 113 was adjudged bankrupt and MNP was appointed Trustee by an Order of this Court on May 12, 2011. The only asset at the date of bankruptcy was cash in the amount of approximately $1.5 million representing the proceeds remaining from the sale of the hotel.

8 126 filed a proof of claim in the 113 bankruptcy, which was allowed by the Trustee as an unsecured claim to the extent of $552,539. This claim included both the $111,000 advanced to 113 by 126, and the payment of $43,404 to the third party subcontractor, both of which involved monies that had originated from Mr. Wurth.

9 The Trustee declared an interim distribution of approx. $1.2 million that was distributed to proven creditors on June 15, 2012. 126 received a dividend of 25.82% of $38,094 (excluding levy).

10 Mr. Wurth became aware that monies were paid by 126 to 113 through the course of the litigation which he had commenced against 126. His counsel first advised MNP that Mr. Wurth was making a claim for $264,000 under s. 67(1)(a) of the *BIA* on December 14, 2012, on the basis that it reflected trust funds held for his benefit that did not form part of the bankrupt's estate. He is now seeking to recover the amount of $154,404 which the Trustee acknowledges was paid by 126 to 113 from funds that originated from Mr. Wurth.

11 On June 4, 2013, the Trustee issued a Notice by Trustee Requiring Filing of a Proof of Claim on Property to Mr. Wurth.

12 On June 14, 2013, Mr. Wurth filed a Reclamation of Property Claim asserting that he provided funds to 126 in trust and that he had reason to believe that $264,000 of those funds were paid to 113 in breach of trust between June and September 2008.

13 On June 28, 2013 the Trustee issued a Notice of Dispute rejecting Mr. Wurth's claim.

14 On July 12, 2013 Mr. Wurth filed this application appealing the Trustee's decision.

15 The Trustee currently holds approximately $344,000 in its trust account of which $144,000 relates to the remaining proceeds from the sale of the Strathmore hotel and $200,000 to a recovery from the Canada Revenue Agency.

Applicable Law

16 Section 81 of the *BIA* states in part:

> 81. (1) Where a person claims any property, or interest therein, in the possession of a bankrupt at the time of the bankruptcy, he shall file with the trustee a proof of claim verified by affidavit giving the grounds on which the claim is based and sufficient particulars to enable the property to be identified.
>
> (2) The trustee with whom a proof of claim is filed under subsection (1) shall within 15 days after the filing of the claim or within 15 days after the first meeting of creditors, whichever is the later, either admit the claim and deliver possession of the property to the claimant or send notice in the prescribed manner to the claimant that the claim is disputed, with the trustee's reasons for disputing it, and, unless the claimant appeals the trustee' decision to the court within 15 days after the sending of the notice of dispute, the claimant is deemed to have abandoned or relinquished all his or her right to or interest in the property to the trustee who may then sell or dispose of the property free of any right, title or interest of the claimant.

(3) The onus of establishing a claim to or in property under this section is on the claimant.

17 Section 67(1)(a) of the *BIA* states:

67. (1) The property of a bankrupt divisible among his creditors shall not comprise

(a) property held by the bankrupt in trust for any other person;

18 In some circumstances liability can be imposed on a stranger to a trust by way of a constructive trust on the basis of "knowing receipt" of trust property, as was outlined by the Supreme Court of Canada in *Citadel General Assurance Co. v. Lloyds Bank Canada*, [1997] 3 S.C.R. 805 (S.C.C.). The Court distinguished between tracing orders at common law and restitutionary remedies based upon the principles of unjust enrichment imposed in equity in "knowing receipt cases" at paras 58 - 59:

> In my view, a distinction should be made between the imposition of liability in "knowing receipt" cases and the availability of tracing orders at common law and in equity. Liability at common law is strict, flowing from the fact of receipt. Liability in "knowing receipt" cases is not strict; it depends not only on the fact of enrichment (i.e. receipt of trust property) but also on the unjust nature of that enrichment (i.e. the stranger's knowledge of the breach of trust). A tracing order at common law, unlike a restitutionary remedy, is only available in respect of funds which have not lost their identity by becoming part of a mixed fund. Further, the imposition of liability as a constructive trustee is wider than a tracing order in equity. The former is not limited to the defence of purchaser without notice and "does not depend upon the recipient still having the property or its traceable proceeds"; see In re Montagu's Settlement Trusts, supra, at p. 276.
>
> Despite these distinctions, there appears to be a common thread running through both "knowing receipt" and tracing cases. That is, constructive knowledge will suffice as the basis for imposing liability on the recipient of misdirected trust funds. Notwithstanding this, it is neither necessary nor desirable to confuse the traditional rules of tracing with the restitutionary principles now applicable to "knowing receipt" cases. This does not mean, however, that a restitutionary remedy and a tracing order are mutually exclusive. Where more than one remedy is available on the facts, the plaintiff should be able to choose the one that is most advantageous. In the present case, the plaintiff did not seek a tracing order. It is therefore unnecessary for me to decide whether such a remedy would have been available on the facts of the present appeal, and I have not explored the issue.

19 In the bankruptcy context, there are additional considerations that may be relevant when dealing with equitable remedies, as was noted in Houlden, GB Morawetz and J Sarra, *Bankruptcy and Insolvency Law of Canada* (4th Ed (loose-leaf)), Vol 2, at 3-41:

> In proving the existence of a constructive trust in a bankruptcy setting, the standard of proof is high; and given that the BIA provides a code by which legislators have balanced the interest of those adversely affected by the bankruptcy, the legal rights of creditors should not be defeated unless it would be unconscionable not to recognize a constructive trust...

20 In *Barnabe v. Touhey* (1995), 26 O.R. (3d) 477 (Ont. C.A.), the Ontario Court of Appeal set aside a declaration that property of a bankrupt was held on a constructive trust where that had the effect of granting to the claimant a floating charge over all of the assets of the bankrupt in priority to the bankrupt's other creditors. The Court found that the unjust enrichment, upon which the constructive trust remedy is based, did not exist in that case. The Court stated, at paras 2 - 6, that:

> We are of the opinion that the remedy of constructive trust is not appropriate in the circumstances. To dispose of this appeal, it is not necessary to refer to all of the arguments dealt with by counsel, since we are of the view that the unjust enrichment on which the constructive trust remedy is based does not exist in this case. To establish the

> unjust enrichment, there must be some specific property which is the subject of the enrichment, that property must have been retained by the person holding it in deprivation of the party claiming the trust, and there must be no juristic reason for the retention.
>
> As to the first requirement, in this case there is no specific property which is the subject of the trust. The property ordered held comprises all of the property of the bankrupts. This alone would probably be sufficient to decide the appeal. However, we will comment on the other requirements to establish an unjust enrichment.
>
> As to the second requirement — that the property must be held in deprivation of the party claiming the unjust enrichment — it is clear that the parties which are said to hold the trust property — the Canadian Imperial Bank of Commerce (the "Bank") or Messrs. Touhey and Sigouin — do not hold it in deprivation of the respondents. The property said to be the subject of the trust is money which, by the order of Farley J., dated May 17, 1990, should have been paid back to the accountant administering the assets of the original "1986" partnership. The motions judge found that these moneys, which were not paid back as they should have been, were deposited in the Bank and used to support the operations of the new "1990" partnership. There is no evidence which clearly establishes that this money was ever paid into the account of the new partnership at the Bank. However, even if it was, there is no evidence that indicates that the funds remain in the hands of the Bank. Indeed, the account involved has generally been in negative balance, and, since it was an operating account of the new partnership, funds were paid in and out of the account over a period in excess of four years before the motions judge made the order imposing a constructive trust. Under those circumstances it is almost impossible to show any true connection between funds which may have been deposited in the "1990" partnership account and the assets of that partnership or of the bankrupts. To overcome this problem the motions judge imposed a constructive trust over all of the assets of the bankrupts. This is contrary to clear law which requires that a constructive trust be imposed over specific property in which the person claiming the trust has a reasonable expectation of obtaining a property interest. While the respondents may not have succeeded in having funds returned to the accountant by Touhey and Sigouin, as required by the order of Farley J., they were not deprived of any of the assets which were made the subject of the constructive trust. They were merely unsecured creditors of Touhey and Sigouin.
>
> As to the third requirement — that there be no juristic reason for the retention of the property — there are at least two juristic reasons why the Bank should retain the funds involved (if they were in fact deposited in the "1990" partnership account). First, the Bank, through the account of the "1990" partnership, financed at least some of the operations of that partnership. In order to do so, it obtained security over the receivables and other assets of the partnership, which are subject to the order of Bell J. It was in reliance on that security that the Bank financed the operations of the "1990" partnership. It was entitled to retain any funds which may have been paid into the account to reimburse it for payments out of the account, and it was entitled to its security for the purpose of securing payment. The second juristic reason for retention of the funds is that the order of Farley J., by its terms, anticipated that the funds paid over by the accountant administering the assets of the "1986" partnership would be returned only if needed and demanded. Funds were also paid over to the other partners in the "1986" partnership, and none were required by the order to hold any funds in trust; indeed, any such order would have rendered the original payment over of no practical benefit to any of the partners.
>
> While a constructive trust, if appropriately established, could have the effect of the beneficiary of the trust receiving payment out of funds which would otherwise become part of the estate of a bankrupt divisible among his creditors, a constructive trust, otherwise unavailable, cannot be imposed for that purpose. This would amount to imposing what may be a fair result as between the constructive trustee and beneficiary, to the unfair detriment of all other creditors of the bankrupt.

21 In *Bassano Growers Ltd. v. Price Waterhouse Ltd.* (1997), 214 A.R. 380 (Alta. Q.B.), aff'd 1998 ABCA 198, 216 A.R. 328 (Alta. C.A.), Medhurst J found no constructive trust existed for the purposes of section 67(1)(a) of the *BIA* as there was no unjust enrichment established. Of note, he stated at paras 19 - 20:

> Before a constructive trust can be imposed, unjust enrichment must be established, see ***Pettkus v. Becker***, [1980] 2 S.C.R. 834. An unjust enrichment occurs where there has been an enrichment, a corresponding deprivation, and no juristic reason to allow the enrichment and deprivation. The Applicants argue that Diamond S was unjustly enriched by virtue of the fact that the funds were retained by it upon bankruptcy. But this reasoning cannot hold in a bankruptcy situation where the assets of the bankrupt are being distributed pursuant to the *BIA*. The British Columbia Court of Appeal was asked to find a constructive trust in National Bank, supra where taxes collected under a deemed trust had not been segregated from the tax collector's own funds. The Court found at 238-40 that there could be no unjust enrichment in such cases. In bankruptcy situations, the creditors who benefit from the failure of a s. 67(1)(a) trust claim are not "enriched," but merely recover what they are owed, and any deprivation experienced by the unsuccessful trust claimants results from the bankruptcy. In other words, the operation of the *BIA* is a juristic reason which precludes the possibility of awarding a constructive trust remedy, ***National Bank***, supra at 238.
>
> Secondly, even constructive trusts require some certainty of subject matter upon which the trust can be impressed. In ***Barnabe v. Touhey*** (1995), 37 C.B.R. (3d) 73 at 74 (Ont. C.A.) the court considered the constructive trust remedy in the bankruptcy context. The Court held that to establish unjust enrichment "there must be some specific property which is the subject of the enrichment, that property must have been retained by the person holding it in deprivation of the party claiming the trust, and there must be no juristic reason for the retention." The Court rejected the claimant's argument because there was no specific identifiable property which was the subject of the trust. Similarly, in the case at bar there is an uncertainty of subject matter which arose upon the commingling and conversion of the deemed trust moneys by Diamond S. No constructive trust arises on the facts before the Court.

22 In affirming this decision on appeal, the Court of Appeal relied on *Barnabe*, in reiterating that "(a) constructive trust cannot arise unless there is identifiable property to which it can attach...": para 13.

Analysis

23 Mr. Wurth seeks an order directing the Trustee to allow his claim to a property interest in $154,404 of the remaining funds held by the Trustee in the bankrupt's Estate. I accept that $154,404 was received by the bankrupt ($111,000 directly and $43,404 indirectly) from trust monies deposited by Mr. Wurth with 126, and that 113 had actual knowledge that such funds were impressed with a trust and were transferred in breach of trust as 113 and 126 were related entities and as Mr. Ostrander was the principal of both entities. Mr. Wurth has established on a balance of probabilities that 126 was in "knowing receipt" of $154,404 transferred in breach of trust. However, the issue which remains to be determined on this application is what remedy is appropriate, having regard to all the circumstances, including how the funds were used by 126 and the stage of 113's bankruptcy.

24 Mr. Wurth is asserting that he is entitled to a form of tracing remedy or constructive trust that would give him a proprietary interest over $154,404 of any remaining funds in the bankrupt's estate. In my view, that remedy is not available to him for several reasons.

25 As the Court recognized in *Citadel*, a plaintiff may have the option to pursue either a restitutionary remedy of a constructive trust or a tracing remedy at common law, where both are available on the facts. In this case, no common law tracing remedy is available as the monies paid by 126 to 113 in breach of trust cannot be traced to any specific assets acquired by 113 as the full $111,000 was expended on various expenses related to the ongoing operations of the hotel, other than $951 used to purchase furniture that would likely have been sold as part of the sale of the hotel, and the $43,404 paid to the subcontractor. While the monies in the Trustee's possession reflect the remaining proceeds from the sale of the hotel, those funds cannot be traced directly to any specific assets acquired with the funds from 126.

26 Mr. Wurth's claim to a constructive trust based on "knowing receipt" and unjust enrichment must also fail due to the fact that he cannot identify specific property which is the subject of the enrichment and is essentially seeking the

equivalent of a floating charge over all the assets of 126. This is not available for the reasons outlined in *Barnabe* and *Bassano*.

27 There is no unjust enrichment in the circumstances where there is a juristic reason for the deprivation due to the operation of the *BIA* as was outlined in *Barnabe* and *Bassano*.

28 Mr. Wurth's claim has been brought too late. No notice was given to the Trustee until December 2012. This was over four years after the money was paid by 126 to 113, 34 months after Mr. Wurth began demanding its return in February 2009, and six months after the Trustee had accepted the claim advanced by 126, which included the funds advanced by Mr. Wurth, and made a distribution accordingly in June 2012. If Mr. Wurth is now given a constructive trust over $154,404 of 113's remaining assets, then 113's other creditors will be detrimentally affected as there will be a double counting and double compensation for that portion of the 126 claim. To the extent that credit has already been given through the bankruptcy proceeding for the full amount of Mr. Wurth's claim as part of the claim of 126, there is no longer any remaining benefit retained by 113 that could support a claim for unjust enrichment.

Conclusion

29 Mr. Wurth's appeal is dismissed.

Appeal dismissed.

End of Document

36

2012 ONCA 816
Ontario Court of Appeal

Sino-Forest Corp., Re

2012 CarswellOnt 14701, 2012 ONCA 816, 114 O.R. (3d) 304,
225 A.C.W.S. (3d) 601, 299 O.A.C. 107, 98 C.B.R. (5th) 20

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

And In the Matter of a Plan of Compromise or Arrangement of Sino-Forest Corporation

S.T. Goudge, Alexandra Hoy, S.E. Pepall JJ.A.

Heard: November 13, 2012
Judgment: November 23, 2012
Docket: C56115, C56118, C56125

Proceedings: affirming *Sino-Forest Corp., Re* (2012), 92 C.B.R. (5th) 99, 2012 CarswellOnt 9430, 2012 ONSC 4377 (Ont. S.C.J. [Commercial List])

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Subject: Insolvency

Headnote

Bankruptcy and insolvency --- Companies' Creditors Arrangement Act — Miscellaneous

In class actions, shareholders alleged that corporation misrepresented assets and financial situation, and that auditors and underwriters failed to detect misrepresentations — Corporation obtained protection under Companies' Creditors Arrangements Act (CCAA) — As yet uncertified class actions were stayed — Supervising judge granted claims procedure order — Auditors and underwriters filed individual proofs of claims against corporation for contribution and indemnity for any amounts they were ordered to pay under class actions — Corporation applied successfully for order that auditors' and underwriters' claims were equity claims under CCAA — Auditors and underwriters appealed — Appeal dismissed — Claims for contribution and indemnity were equity claims under s. 2(1)(e) of CCAA — Parliament intended that monetary loss suffered by shareholder not diminish assets available to general creditors — "Equity claim" was not confined by its definition, or by definition of "claim", to claim advanced by holder of equity interest — Parliament could have but did not include language restricting claims for contribution or indemnity to those made by shareholders — Logic of s. 2(1)(a) to (e) supported notion that s. 2(1)(e) referred to claims for contribution or indemnity not by shareholders, but by others — Definition of "equity claim" was sufficiently clear to alter pre-existing common law — If shareholder sued auditors and underwriters for loss, and they claimed contribution or indemnity against debtor, assets available to general creditors would be diminished by amount of claims for contribution and indemnity.

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s. 2 "claim provable in bankruptcy" — considered

s. 121(1) — considered

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s. 2(1) "claim" — considered

s. 2(1) "equity claim" — considered

s. 2(1) "equity claim" (a)-(d) — referred to

s. 2(1) "equity claim" (a)-(e) — referred to

s. 2(1) "equity claim" (d) — considered

s. 2(1) "equity claim" (e) — considered

s. 2(1) "equity interest" — considered

s. 6(8) — considered

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Words and phrases considered:

equity claim

This appeal considers the definition of "equity claim" in s. 2(1) of the CCAA [*Companies' Creditors Arrangement Act*, R.S.C. 1985, c. C-36]. More particularly, the central issue is whether claims by auditors and underwriters against the respondent debtor . . . for contribution and indemnity fall within that definition. The claims arise out of proposed shareholder class actions for misrepresentation.

. . . . .

We agree with the supervising judge that the definition of equity claim focuses on the nature of the claim, and not the identity of the claimant. In our view, the appellants' claims for contribution and indemnity are clearly equity claims.

. . . . .

"Equity claim" is not confined by its definition, or by the definition of "claim", to a claim advanced by the holder of an equity interest. Parliament could have, but did not, include language in paragraph (e) restricting claims for contribution or indemnity to those made by shareholders.

APPEAL by auditors and underwriters from judgment reported at *Sino-Forest Corp., Re* (2012), 92 C.B.R. (5th) 99, 2012 CarswellOnt 9430, 2012 ONSC 4377 (Ont. S.C.J. [Commercial List]) granting application by corporation for order that auditors' and underwriters' claims were equity claims under statute.

***Per curiam*:**

I Overview

1 In 2009, the *Companies' Creditors Arrangement Act*, R.S.C. 1985, c. C-36, as amended ("CCAA"), was amended to expressly provide that general creditors are to be paid in full before an equity claim is paid.

2 This appeal considers the definition of "equity claim" in s. 2(1) of the CCAA. More particularly, the central issue is whether claims by auditors and underwriters against the respondent debtor, Sino-Forest Corporation ("Sino-Forest"), for contribution and indemnity fall within that definition. The claims arise out of proposed shareholder class actions for misrepresentation.

3 The appellants argue that the supervising judge erred in concluding that the claims at issue are equity claims within the meaning of the CCAA and in determining the issue before the claims procedure established in Sino-Forest's CCAA proceeding had been completed.

4 For the reasons that follow, we conclude that the supervising judge did not err and accordingly dismiss this appeal.

II The Background

(a) The Parties

5 Sino-Forest is a Canadian public holding company that holds the shares of numerous subsidiaries, which in turn own, directly or indirectly, forestry assets located principally in the People's Republic of China. Its common shares are listed on the Toronto Stock Exchange. Sino-Forest also issued approximately $1.8 billion of unsecured notes, in four series. Trading in Sino-Forest shares ceased on August 26, 2011, as a result of a cease-trade order made by the Ontario Securities Commission.

6 The appellant underwriters [1] provided underwriting services in connection with three separate Sino-Forest equity offerings in June 2007, June 2009 and December 2009, and four separate Sino-Forest note offerings in July 2008, June 2009, December 2009 and October 2010. Certain underwriters entered into agreements with Sino-Forest in which Sino-Forest agreed to indemnify the underwriters in connection with an array of matters that could arise from their participation in these offerings.

7 The appellant BDO Limited ("BDO") is a Hong Kong-based accounting firm that served as Sino-Forest's auditor between 2005 and August 2007 and audited its annual financial statements for the years ended December 31, 2005 and December 31, 2006.

8 The engagement agreements governing BDO's audits of Sino-Forest provided that the company's management bore the primary responsibility for preparing its financial statements in accordance with Generally Accepted Accounting Principles ("GAAP") and implementing internal controls to prevent and detect fraud and error in relation to its financial reporting.

9 BDO's Audit Report for 2006 was incorporated by reference into a June 2007 prospectus issued by Sino-Forest regarding the offering of its shares to the public. This use by Sino-Forest was governed by an engagement agreement dated May 23, 2007, in which Sino-Forest agreed to indemnify BDO in respect of any claims by the underwriters or any third party that arose as a result of the further steps taken by BDO in relation to the issuance of the June 2007 prospectus.

10 The appellant Ernst & Young LLP ("E&Y") served as Sino-Forest's auditor for the years 2007 to 2012 and delivered Auditors' Reports with respect to the consolidated financial statements of Sino-Forest for fiscal years ended December 31, 2007 to 2010, inclusive. In each year for which it prepared a report, E&Y entered into an audit engagement letter with Sino-Forest in which Sino-Forest undertook to prepare its financial statements in accordance with GAAP, design and implement internal controls to prevent and detect fraud and error, and provide E&Y with its complete financial records and related information. Some of these letters contained an indemnity in favour of E&Y.

11 The respondent Ad Hoc Committee of Noteholders consists of noteholders owning approximately one-half of Sino-Forest's total noteholder debt. [2] They are creditors who have debt claims against Sino-Forest; they are not equity claimants.

12 Sino-Forest has insufficient assets to satisfy all the claims against it. To the extent that the appellants' claims are accepted and are treated as debt claims rather than equity claims, the noteholders' recovery will be diminished.

(b) The Class Actions

13 In 2011 and January of 2012, proposed class actions were commenced in Ontario, Quebec, Saskatchewan and New York State against, amongst others, Sino-Forest, certain of its officers, directors and employees, BDO, E&Y and the underwriters. Sino-Forest is sued in all actions. [3]

14 The proposed representative plaintiffs in the class actions are shareholders of Sino-Forest. They allege that: Sino-Forest repeatedly misrepresented its assets and financial situation and its compliance with GAAP in its public disclosure; the appellant auditors and underwriters failed to detect these misrepresentations; and the appellant auditors misrepresented that their audit reports were prepared in accordance with generally accepted auditing standards ("GAAS"). The representative plaintiffs claim that these misrepresentations artificially inflated the price of Sino-Forest's shares and that proposed class members suffered damages when the shares fell after the truth was revealed in 2011.

15 The representative plaintiffs in the Ontario class action seek approximately $9.2 billion in damages. The Quebec, Saskatchewan and New York class actions do not specify the quantum of damages sought.

16 To date, none of the proposed class actions has been certified.

(c) CCAA Protection and Proofs of Claim

17 On March 30, 2012, Sino-Forest sought protection pursuant to the provisions of the CCAA. Morawetz J. granted the initial order which, among other things, appointed FTI Consulting Canada Inc. as the Monitor and stayed the class actions as against Sino-Forest. Since that time, Morawetz J. has been the supervising judge of the CCAA proceedings. The initial stay of the class actions was extended and broadened by order dated May 8, 2012.

18 On May 14, 2012, the supervising judge granted an unopposed claims procedure order which established a procedure to file and determine claims against Sino-Forest.

19 Thereafter, all of the appellants filed individual proofs of claim against Sino-Forest seeking contribution and indemnity for, among other things, any amounts that they are ordered to pay as damages to the plaintiffs in the class actions. Their proofs of claim advance several different legal bases for Sino-Forest's alleged obligation of contribution and indemnity, including breach of contract, contractual terms of indemnity, negligent and fraudulent misrepresentation in tort, and the provisions of the *Negligence Act*, R.S.O. 1990, c. N.1.

(d) Order under Appeal

20 Sino-Forest then applied for an order that the following claims are equity claims under the CCAA: claims against Sino-Forest arising from the ownership, purchase or sale of an equity interest in the company, including shareholder

claims ("Shareholder Claims"); and any indemnification claims against Sino-Forest related to or arising from the Shareholder Claims, including the appellants' claims for contribution or indemnity ("Related Indemnity Claims").

21 The motion was supported by the Ad Hoc Committee of Noteholders.

22 On July 27, 2012, the supervising judge granted the order sought by Sino-Forest and released a comprehensive endorsement.

23 He concluded that it was not premature to determine the equity claims issue. It had been clear from the outset of Sino-Forest's CCAA proceedings that this issue would have to be decided and that the expected proceeds arising from any sales process would be insufficient to satisfy the claims of creditors. Furthermore, the issue could be determined independently of the claims procedure and without prejudice being suffered by any party.

24 He also concluded that both the Shareholder Claims and the Related Indemnity Claims should be characterized as equity claims. In summary, he reasoned that:

• The characterization of claims for indemnity turns on the characterization of the underlying primary claims. The Shareholder Claims are clearly equity claims and they led to and underlie the Related Indemnity Claims;

• The plain language of the CCAA, which focuses on the nature of the claim rather than the identity of the claimant, dictates that both Shareholder Claims and Related Indemnity Claims constitute equity claims;

• The definition of "equity claim" added to the CCAA in 2009 broadened the scope of equity claims established by pre-amendment jurisprudence;

• This holding is consistent with the analysis in *Return on Innovation Capital Ltd. v. Gandi Innovations Ltd.*, 2011 ONSC 5018, 83 C.B.R. (5th) 123 (Ont. S.C.J. [Commercial List]), which dealt with contractual indemnification claims of officers and directors. Leave to appeal was denied by this court, 2012 ONCA 10, 90 C.B.R. (5th) 141 (Ont. C.A.); and

• "It would be totally inconsistent to arrive at a conclusion that would enable either the auditors or the underwriters, through a claim for indemnification, to be treated as creditors when the underlying actions of shareholders cannot achieve the same status" (para. 82). To hold otherwise would run counter to the scheme established by the CCAA and would permit an indirect remedy to the shareholders when a direct remedy is unavailable.

25 The supervising judge did not characterize the full amount of the claims of the auditors and underwriters as equity claims. He excluded the claims for defence costs on the basis that while it was arguable that they constituted claims for indemnity, they were not necessarily in respect of an equity claim. That determination is not appealed.

III Interpretation of "Equity Claim"

(a) Relevant Statutory Provisions

26 As part of a broad reform of Canadian insolvency legislation, various amendments to the CCAA were proclaimed in force as of September 18, 2009.

27 They included the addition of s. 6(8):

> No compromise or arrangement that provides for the payment of an equity claim is to be sanctioned by the court unless it provides that all claims that are not equity claims are to be paid in full before the equity claim is to be paid.

Section 22.1, which provides that creditors with equity claims may not vote at any meeting unless the court orders otherwise, was also added.

28 Related definitions of "claim", "equity claim", and "equity interest" were added to s. 2(1) of the CCAA:

> In this Act,
>
> . . . . .
>
> "claim" means any indebtedness, liability or obligation of any kind that would be a claim provable within the meaning of section 2 of the *Bankruptcy and Insolvency Act*;
>
> . . . . .
>
> "equity claim" means a claim that is in respect of an equity interest, including a claim for, among others,
>
> (a) a dividend or similar payment,
>
> (b) a return of capital,
>
> (c) a redemption or retraction obligation,
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> (d) a monetary loss resulting from the ownership, purchase or sale of an equity interest or from the rescission, or, in Quebec, the annulment, of a purchase or sale of an equity interest, or
>
> (e) contribution or indemnity in respect of a claim referred to in any of paragraphs (a) to (d); [Emphasis added.]
>
> "equity interest" means
>
> (a) in the case of a company other than an income trust, a share in the company — or a warrant or option or another right to acquire a share in the company — other than one that is derived from a convertible debt, and
>
> (b) in the case of an income trust, a unit in the income trust — or a warrant or option or another right to acquire a unit in the income trust — other than one that is derived from a convertible debt;

29 Section 2 of the *Bankruptcy and Insolvency Act*, R.S.C. 1985, c. B-3 ("BIA") defines a "claim provable in bankruptcy". Section 121 of the BIA in turn specifies that claims provable in bankruptcy are those to which the bankrupt is subject.

> 2. "claim provable in bankruptcy", "provable claim" or "claim provable" includes any claim or liability provable in proceedings under this Act by a creditor;
>
> 121. (1) All debts and liabilities, present or future, to which the bankrupt is subject on the day on which the bankrupt becomes bankrupt or to which the bankrupt may become subject before the bankrupt's discharge by reason of any obligation incurred before the day on which the bankrupt becomes bankrupt shall be deemed to be claims provable in proceedings under this Act. [Emphasis added.]

(b) The Legal Framework Before the 2009 Amendments

30 Even before the 2009 amendments to the CCAA codified the treatment of equity claims, the courts subordinated shareholder equity claims to general creditors' claims in an insolvency. As the supervising judge described:

> [23] Essentially, shareholders cannot reasonably expect to maintain a financial interest in an insolvent company where creditor claims are not being paid in full. Simply put, shareholders have no economic interest in an insolvent enterprise.
>
> [24] The basis for the differentiation flows from the fundamentally different nature of debt and equity investments. Shareholders have unlimited upside potential when purchasing shares. Creditors have no corresponding upside potential.

> [25] As a result, courts subordinated equity claims and denied such claims a vote in plans of arrangement. [Citations omitted.] [4]

(c) The Appellants' Submissions

31 The appellants essentially advance three arguments.

32 First, they argue that on a plain reading of s. 2(1), their claims are excluded. They focus on the opening words of the definition of "equity claim" and argue that their claims against Sino-Forest are not claims that are "in respect of an equity interest" because they do not have an equity interest in Sino-Forest. Their relationships with Sino-Forest were purely contractual and they were arm's-length creditors, not shareholders with the risks and rewards attendant to that position. The policy rationale behind ranking shareholders below creditors is not furthered by characterizing the appellants' claims as equity claims. They were service providers with a contractual right to an indemnity from Sino-Forest.

33 Second, the appellants focus on the term "claim" in paragraph (e) of the definition of "equity claim", and argue that the claims in respect of which they seek contribution and indemnity are the shareholders' claims against them in court proceedings for damages, which are not "claims" against Sino-Forest provable within the meaning of the BIA, and, therefore, not "claims" within s. 2(1). They submit that the supervising judge erred in focusing on the characterization of the underlying primary claims.

34 Third, the appellants submit that the definition of "equity claim" is not sufficiently clear to have changed the existing law. It is assumed that the legislature does not intend to change the common law without "expressing its intentions to do so with irresistible clearness": *Parry Sound (District) Welfare Administration Board v. O.P.S.E.U., Local 324*, 2003 SCC 42, [2003] 2 S.C.R. 157 (S.C.C.), at para. 39, citing *Goodyear Tire & Rubber Co. of Canada Ltd. v. T. Eaton Co.*, [1956] S.C.R. 610 (S.C.C.), at p. 614. The appellants argue that the supervising judge's interpretation of "equity claim" dramatically alters the common law as reflected in *National Bank of Canada v. Merit Energy Ltd.*, 2001 ABQB 583, 294 A.R. 15 (Alta. Q.B.) , aff'd 2002 ABCA 5, 299 A.R. 200 (Alta. C.A.). There the court determined that in an insolvency, claims of auditors and underwriters for indemnification are not to be treated in the same manner as claims by shareholders. Furthermore, the Senate debates that preceded the enactment of the amendments did not specifically comment on the effect of the amendments on claims by auditors and underwriters. The amendments should be interpreted as codifying the pre-existing common law as reflected in *National Bank of Canada v. Merit Energy Ltd.*

35 The appellants argue that the decision of *Return on Innovation Capital Ltd. v. Gandi Innovations Ltd.* is distinguishable because it dealt with the characterization of claims for damages by an equity investor against officers and directors, and it predated the 2009 amendments. In any event, this court confirmed that its decision denying leave to appeal should not be read as a judicial precedent for the interpretation of the meaning of "equity claim" in s. 2(1) of the CCAA.

(d) Analysis

(i) Introduction

36 The exercise before this court is one of statutory interpretation. We are therefore guided by the following oft-cited principle from Elmer A. Driedger, *Construction of Statutes*, 2d ed. (Toronto: Butterworths, 1983), at p. 87:

> [T]he words of an Act are to be read in their entire context and in their grammatical and ordinary sense harmoniously with the scheme of the Act, the object of the Act, and the intention of Parliament.

37 We agree with the supervising judge that the definition of equity claim focuses on the nature of the claim, and not the identity of the claimant. In our view, the appellants' claims for contribution and indemnity are clearly equity claims.

38 The appellants' arguments do not give effect to the expansive language adopted by Parliament in defining "equity claim" and read in language not incorporated by Parliament. Their interpretation would render paragraph (e) of the definition meaningless and defies the logic of the section.

(ii) The expansive language used

39 The definition incorporates two expansive terms.

40 First, Parliament employed the phrase "*in respect of*" twice in defining equity claim: in the opening portion of the definition, it refers to an equity claim as a "claim that is *in respect of* an equity interest", and in paragraph (e) it refers to "contribution or indemnity *in respect of* a claim referred to in any of paragraphs (a) to (d)" (emphasis added).

41 The Supreme Court of Canada has repeatedly held that the words "in respect of" are "of the widest possible scope", conveying some link or connection between two related subjects. In *CanadianOxy Chemicals Ltd. v. Canada (Attorney General)*, [1999] 1 S.C.R. 743 (S.C.C.), at para. 16, citing *Nowegijick v. R.*, [1983] 1 S.C.R. 29 (S.C.C.), at p. 39, the Supreme Court held as follows:

> The words "in respect of" are, in my opinion, words of the widest possible scope. They import such meanings as "in relation to", "with reference to" or "in connection with". The phrase "in respect of" is probably the widest of any expression intended to convey some connection between two related subject matters. [Emphasis added in *CanadianOxy*.]

That court also stated as follows in *Markevich v. Canada*, 2003 SCC 9, [2003] 1 S.C.R. 94 (S.C.C.), at para. 26:

> The words "in respect of" have been held by this Court to be words of the broadest scope that convey some link between two subject matters. [Citations omitted.]

42 It is conceded that the Shareholder Claims against Sino-Forest are claims for "a monetary loss resulting from the ownership, purchase or sale of an equity interest", within the meaning of paragraph (d) of the definition of "equity claim". There is an obvious link between the appellants' claims against Sino-Forest for contribution and indemnity and the shareholders' claims against Sino-Forest. The legal proceedings brought by the shareholders asserted their claims against Sino-Forest together with their claims against the appellants, which gave rise to these claims for contribution and indemnity. The causes of action asserted depend largely on common facts and seek recovery of the same loss.

43 The appellants' claims for contribution or indemnity against Sino-Forest are therefore clearly connected to or "in respect of" a claim referred to in paragraph (d), namely the shareholders' claims against Sino-Forest. They are claims in respect of equity claims by shareholders and are provable in bankruptcy against Sino-Forest.

44 Second, Parliament also defined equity claim as "including a claim for, among others", the claims described in paragraphs (a) to (e). The Supreme Court has held that this phrase "including" indicates that the preceding words - "a claim that is in respect of an equity interest" - should be given an expansive interpretation, and include matters which might not otherwise be within the meaning of the term, as stated in *National Bank of Greece (Canada) c. Katsikonouris*, [1990] 2 S.C.R. 1029 (S.C.C.), at p. 1041:

> [T]hese words are terms of extension, designed to enlarge the meaning of preceding words, and not to limit them.
>
> ... [T]he natural inference is that the drafter will provide a specific illustration of a subset of a given category of things in order to make it clear that that category extends to things that might otherwise be expected to fall outside it.

45 Accordingly, the appellants' claims, which clearly fall within paragraph (e), are included within the meaning of the phrase a "claim that is in respect of an equity interest".

(iii) What Parliament did not say

46 "Equity claim" is not confined by its definition, or by the definition of "claim", to a claim advanced by the holder of an equity interest. Parliament could have, but did not, include language in paragraph (e) restricting claims for contribution or indemnity to those made by shareholders.

(iv) An interpretation that avoids surplusage

47 A claim for contribution arises when the claimant for contribution has been sued. Section 2 of the *Negligence Act* provides that a tortfeasor may recover contribution or indemnity from any other tortfeasor who is, or would if sued have been, liable in respect of the damage to any person suffering damage as a result of a tort. The securities legislation of the various provinces provides that an issuer, its underwriters, and, if they consented to the disclosure of information in the prospectus, its auditors, among others, are jointly and severally liable for a misrepresentation in the prospectus, and provides for rights of contribution. [5]

48 Counsel for the appellants were unable to provide a satisfactory example of when a holder of an equity interest in a debtor company would seek contribution under paragraph (e) against the debtor in respect of a claim referred to in any of paragraphs (a) to (d). In our view, this indicates that paragraph (e) was drafted with claims for contribution or indemnity by non-shareholders rather than shareholders in mind.

49 If the appellants' interpretation prevailed, and only a person with an equity interest could assert such a claim, paragraph (e) would be rendered meaningless, and as Lamer C.J. wrote in *R. v. Proulx*, 2000 SCC 5, [2000] 1 S.C.R. 61 (S.C.C.), at para. 28:

> It is a well accepted principle of statutory interpretation that no legislative provision should be interpreted so as to render it mere surplusage.

(v) The scheme and logic of the section

50 Moreover, looking at s. 2(1) as a whole, it would appear that the remedies available to shareholders are all addressed by ss. 2(1)(a) to (d). The logic of ss. 2(1)(a) to (e) therefore also supports the notion that paragraph (e) refers to claims for contribution or indemnity not by shareholders, but by others.

(vi) The legislative history of the 2009 amendments

51 The appellants and the respondents each argue that the legislative history of the amendments supports their respective interpretation of the term "equity claim". We have carefully considered the legislative history. The limited commentary is brief and imprecise. The clause by clause analysis of Bill C-12 comments that "[a]n equity claim is defined to include any claim that is related to an equity interest". [6] While, as the appellants submit, there was no specific reference to the position of auditors and underwriters, the desirability of greater conformity with United States insolvency law to avoid forum shopping by debtors was highlighted in 2003, some four years before the definition of "equity claim" was included in Bill C-12.

52 In this instance the legislative history ultimately provided very little insight into the intended meaning of the amendments. We have been guided by the plain words used by Parliament in reaching our conclusion.

(vii) Intent to change the common law

53 In our view the definition of "equity claim" is sufficiently clear to alter the pre-existing common law. *National Bank of Canada v. Merit Energy Ltd.*, an Alberta decision, was the single case referred to by the appellants that addressed the treatment of auditors' and underwriters' claims for contribution and indemnity in an insolvency before the definition was enacted. As the supervising judge noted, in a more recent decision, *Return on Innovation Capital Ltd. v. Gandi Innovations*

Ltd., the courts of this province adopted a more expansive approach, holding that contractual indemnification claims of directors and officers were equity claims.

54 We are not persuaded that the practical effect of the change to the law implemented by the enactment of the definition of "equity claim" is as dramatic as the appellants suggest. The operations of many auditors and underwriters extend to the United States, where contingent claims for reimbursement or contribution by entities "liable with the debtor" are disallowed pursuant to § 502(e)(1)(B) of the U.S. Bankruptcy Code, 11 U.S.C.S. [7]

(viii) The purpose of the legislation

55 The supervising judge indicated that if the claims of auditors and underwriters for contribution and indemnity were not included within the meaning of "equity claim", the CCAA would permit an indirect remedy to the shareholders when a direct remedy is not available. We would express this concept differently.

56 In our view, in enacting s. 6(8) of the CCAA, Parliament intended that a monetary loss suffered by a shareholder (or other holder of an equity interest) in respect of his or her equity interest *not* diminish the assets of the debtor available to general creditors in a restructuring. If a shareholder sues auditors and underwriters in respect of his or her loss, in addition to the debtor, and the auditors or underwriters assert claims of contribution or indemnity against the debtor, the assets of the debtor available to general creditors would be diminished by the amount of the claims for contribution and indemnity.

IV Prematurity

57 We are not persuaded that the supervising judge erred by determining that the appellants' claims were equity claims before the claims procedure established in Sino-Forest's CCAA proceeding had been completed.

58 The supervising judge noted at para. 7 of his endorsement that from the outset, Sino-Forest, supported by the Monitor, had taken the position that it was important that these proceedings be completed as soon as possible. The need to address the characterization of the appellants' claims had also been clear from the outset. The appellants have not identified any prejudice that arises from the determination of the issue at this stage. There was no additional information that the appellants have identified that was not before the supervising judge. The Monitor, a court-appointed officer, supported the motion procedure. The supervising judge was well positioned to determine whether the procedure proposed was premature and, in our view, there is no basis on which to interfere with the exercise of his discretion.

V Summary

59 In conclusion, we agree with the supervising judge that the appellants' claims for contribution or indemnity are equity claims within s. 2(1)(e) of the CCAA.

60 We reach this conclusion because of what we have said about the expansive language used by Parliament, the language Parliament did not use, the avoidance of surplusage, the logic of the section, and what, from the foregoing, we conclude is the purpose of the 2009 amendments as they relate to these proceedings.

61 We see no basis to interfere with the supervising judge's decision to consider whether the appellants' claims were equity claims before the completion of the claims procedure.

VI Disposition

62 This appeal is accordingly dismissed. As agreed, there will be no costs.

Appeal dismissed.

Footnotes

1 Credit Suisse Securities (Canada) Inc., TD Securities Inc., Dundee Securities Corporation (now known as DWM Securities Inc.), RBC Dominion Securities Inc., Scotia Capital Inc., CIBC World Markets Inc., Merrill Lynch Canada Inc., Canaccord Financial Ltd. (now known as Canaccord Genuity Corp.), Maison Placements Canada Inc., Credit Suisse Securities (USA) LLC and Merrill Lynch, Pierce, Fenner & Smith Incorporated, successor by merger to Banc of America Securities LLC.

2 Noteholders holding in excess of $1.296 billion, or 72%, of Sino-Forest's approximately $1.8 billion in noteholders' debt have executed written support agreements in favour of the Sino-Forest CCAA plan as of March 30, 2012. These include noteholders represented by the Ad Hoc Committee of Noteholders.

3 None of the appellants are sued in Saskatchewan and all are sued in Ontario. E&Y is also sued in Quebec and New York and the appellant underwriters are also sued in New York.

4 The supervising judge cited the following cases as authority for these propositions: *Blue Range Resource Corp., Re*, 2000 ABQB 4, 259 A.R. 30 (Alta. Q.B.); *Stelco Inc., Re* (2006), 17 C.B.R. (5th) 78 (Ont. S.C.J. [Commercial List]); *Central Capital Corp. (Re)* (1996), 27 O.R. (3d) 494 (Ont. C.A.); *Nelson Financial Group Ltd., Re*, 2010 ONSC 6229, 71 C.B.R. (5th) 153 (Ont. S.C.J. [Commercial List]); *EarthFirst Canada Inc., Re*, 2009 ABQB 316, 56 C.B.R. (5th) 102 (Alta. Q.B.).

5 *Securities Act*, R.S.O. 1990, c. S.5, s. 130(1), (8); *Securities Act*, R.S.A. 2000, c. S-4, s. 203(1), (10); *Securities Act*, R.S.B.C. 1996, c. 418, s. 131(1), (11); *The Securities Act*, C.C.S.M. c. S50, s. 141(1), (11); *Securities Act*, S.N.B. 2004, c. S-5.5, s. 149(1), (9); *Securities Act*, R.S.N.L. 1990, c. S-13, s. 130(1), (8); *Securities Act*, R.S.N.S. 1989, c. 418, s. 137(1), (8); *Securities Act*, S.Nu. 2009, c. 12, s. 111(1), (12); *Securities Act*, S.N.W.T. 2008, c. 10, s. 111(1), (12); *Securities Act*, R.S.P.E.I. 1988, c. S-3.1, s. 111(1), (12); *Securities Act*, R.S.Q. c. V-1.1, ss. 218, 219, 221; *The Securities Act, 1988*, S.S. 1988-89, c. S-42.2, s. 137(1), (9); *Securities Act*, S.Y. 2007, c. 16, s. 111(1), (13).

6 We understand that this analysis was before the Standing Senate Committee on Banking, Trade and Commerce in 2007.

7 The United States Bankruptcy Court for the District of Delaware in *In Re: Mid-American Waste Systems, Inc.* 228 B.R. 816 (1999), indicated that this provision applies to underwriters' claims, and reflects the policy rationale that such stakeholders are in a better position to evaluate the risks associated with the issuance of stock than are general creditors.

End of Document

37

2010 ONSC 6229
Ontario Superior Court of Justice [Commercial List]

Nelson Financial Group Ltd., Re

2010 CarswellOnt 8655, 2010 ONSC 6229, 195 A.C.W.S. (3d) 319, 71 C.B.R. (5th) 153, 75 B.L.R. (4th) 302

IN THE MATTER OF THE COMPANIES' CREDITORS ARRANGEMENT ACT, R.S.C. 1985, C-36, AS AMENDED AND IN THE MATTER OF A PLAN OF COMPROMISE OR ARRANGEMENT OF NELSON FINANCIAL GROUP LTD.

Pepall J.

Judgment: November 16, 2010
Docket: 10-8630-00CL

Counsel: Richard B. Jones, Douglas Turner, Q.C. for Noteholders / Moving Party
J.H. Grout, S. Aggarwal for Monitor
Pamela Foy for Ontario Securities Commission
Frank Lamie for Nelson Financial Group Ltd.
Robert Benjamin Mills, Harold Van Winssen for Respondents, Clifford Styles, Jackie Styles, Play Investments Ltd.
Michael Beardsley, Respondent for himself
Clifford Holland, Respondent for himself
Arnold Bolliger, Respondent for himself
John McVey, Respondent for himself
Joan Frederick, Respondent for herself
Rakesh Sharma, Respondent for himself
Larry Debono, Respondent for himself
Keith McClear, Respondent for himself

Subject: Corporate and Commercial; Insolvency

Headnote

Business associations --- Specific matters of corporate organization — Shareholders — General principles — Whether creditor of corporation

N Ltd. raised funds by issuing promissory notes bearing 12 percent annual return and issued preference shares with typical annual dividend of 10 percent — Funds were then lent out at much higher interest rates — N Ltd. sought protection of Companies' Creditors Arrangement Act — Preferred shareholders alleged, inter alia, theft, fraud, misrepresentation, breach of trust, excessive dividend payments, conversion of notes into preferred shares while N Ltd. was insolvent, oppression, and breach of fiduciary duties against N Ltd. — Promissory note holders brought motion to have all claims of preferred shareholders against N Ltd. classified as equity claims within meaning of Act; and requesting that unsecured creditors be entitled to be paid in full before preferred shareholders and other relief — Motion granted, subject to two possible exceptions — Claims of preferred shareholders fell within ambit of s. 2 of Act, were governed by ss. 6(8) and 22.1 of Act, and therefore did not constitute claims provable for purposes of statute — Preferred shareholders were not creditors of N Ltd. — Shares were treated as equity in N Ltd.'s financial statements and in its books and records — Substance of arrangement between preferred shareholders and N Ltd. was relationship based on equity, not debt — Pursuant to ss. 6(8) and 22.1, equity claims are rendered subordinate to those of creditors — Types of claims advanced by preferred shareholders were captured by language of recent amendments to Act — Factual record on two possible exceptions was incomplete — Monitor to investigate both scenarios — Claims procedure to be amended.

Bankruptcy and insolvency --- Companies' Creditors Arrangement Act — Miscellaneous

N Ltd. raised funds by issuing promissory notes bearing 12 percent annual return and issued preference shares with typical annual dividend of 10 percent — Funds were then lent out at much higher interest rates — N Ltd. sought protection of Companies' Creditors Arrangement Act — Preferred shareholders alleged, inter alia, theft, fraud, misrepresentation, breach of trust, excessive dividend payments, conversion of notes into preferred shares while N Ltd. was insolvent, oppression, and breach of fiduciary duties against N Ltd. — Promissory note holders brought motion to have all claims of preferred shareholders against N Ltd. classified as equity claims within meaning of Act; and requesting that unsecured creditors be entitled to be paid in full before preferred shareholders and other relief — Motion granted, subject to two possible exceptions — Claims of preferred shareholders fell within ambit of s. 2 of Act, were governed by ss. 6(8) and 22.1 of Act, and therefore did not constitute claims provable for purposes of statute — Preferred shareholders were not creditors of N Ltd. — Shares were treated as equity in N Ltd.'s financial statements and in its books and records — Substance of arrangement between preferred shareholders and N Ltd. was relationship based on equity, not debt — Pursuant to ss. 6(8) and 22.1, equity claims are rendered subordinate to those of creditors — Types of claims advanced by preferred shareholders were captured by language of recent amendments to Act — Factual record on two possible exceptions was incomplete — Monitor to investigate both scenarios — Claims procedure to be amended.

Table of Authorities

Cases considered by *Pepall J.*:

Blue Range Resource Corp., Re (2000), 2000 CarswellAlta 12, 259 A.R. 30, 76 Alta. L.R. (3d) 338, [2000] 4 W.W.R. 738, 2000 ABQB 4, 15 C.B.R. (4th) 169 (Alta. Q.B.) — considered

Central Capital Corp., Re (1996), 132 D.L.R. (4th) 223, 27 O.R. (3d) 494, *(*sub nom. *Royal Bank v. Central Capital Corp.)* 88 O.A.C. 161, 1996 CarswellOnt 316, 38 C.B.R. (3d) 1, 26 B.L.R. (2d) 88 (Ont. C.A.) — followed

EarthFirst Canada Inc., Re (2009), 2009 ABQB 316, 2009 CarswellAlta 1069, 56 C.B.R. (5th) 102 (Alta. Q.B.) — considered

I. Waxman & Sons Ltd., Re (2008), 89 O.R. (3d) 427, 39 E.T.R. (3d) 49, 44 B.L.R. (4th) 295, 2008 CarswellOnt 1245, 40 C.B.R. (5th) 307, 64 C.C.E.L. (3d) 233 (Ont. S.C.J. [Commercial List]) — considered

Matter of Stirling Homex Corp. (1978), 579 F.2d 206 (U.S. 2nd Cir. N.Y.) — considered

National Bank of Canada v. Merit Energy Ltd. (2001), 2001 ABQB 583, 2001 CarswellAlta 913, 28 C.B.R. (4th) 228, [2001] 10 W.W.R. 305, 95 Alta. L.R. (3d) 166, 294 A.R. 15 (Alta. Q.B.) — considered

National Bank of Canada v. Merit Energy Ltd. (2002), 2002 ABCA 5, 2002 CarswellAlta 23, [2002] 3 W.W.R. 215, 96 Alta. L.R. (3d) 1, 299 A.R. 200, 266 W.A.C. 200 (Alta. C.A.) — referred to

Statutes considered:

Bankruptcy and Insolvency Act, R.S.C. 1985, c. B-3
s. 2 — considered

s. 2 "creditor" — considered

s. 121(1) — considered

Business Corporations Act, R.S.O. 1990, c. B.16
Generally — referred to

s. 23(3) — referred to

s. 248 — referred to

Companies' Creditors Arrangement Act, R.S.C. 1985, c. C-36
Generally — referred to

s. 2 — referred to

s. 2(1) "claim" — considered

s. 2(1) "equity claim" — considered

s. 2(1) "equity interest" — considered

s. 6(8) — considered

s. 22.1 [en. 2007, c. 36, s. 71] — considered

Securities Act, R.S.O. 1990, c. S.5
Generally — referred to

MOTION by promissory note holders to determine whether certain claims of preferred shareholders constitute equity claims for purposes of *Companies' Creditors Arrangement Act*.

***Pepall J.*:**

1 This motion addresses the legal characterization of claims of holders of preferred shares in the capital stock of the applicant, Nelson Financial Group Ltd. ("Nelson"). The issue before me is to determine whether such claims constitute equity claims for the purposes of sections 6(8) and 22.1 of the *Companies' Creditors Arrangement Act* ("*CCAA*").

Background Facts

2 Nelson was incorporated pursuant to the *Business Corporations Act* of Ontario in September, 1990. Nelson raised money from investors and then used those funds to extend credit to customers in vendor assisted financing programmes. It raised money in two ways. It issued promissory notes bearing a rate of return of 12% per annum and also issued preference shares typically with an annual dividend of 10%. [1] The funds were then lent out at significantly higher rates of interest.

3 The Monitor reported that Nelson placed ads in selected publications. The ads outlined the nature of the various investment options. Term sheets for the promissory notes or the preferred shares were then provided to the investors by Nelson together with an outline of the proposed tax treatment for the investment. No funds have been raised from investors since January 29, 2010.

(a) Noteholders

4 As of the date of the *CCAA* filing on March 23, 2010, Nelson had issued 685 promissory notes in the aggregate principal amount of $36,583,422.89. The notes are held by approximately 321 people.

(b) Preferred Shareholders

5 Nelson was authorized to issue two classes of common shares and 2,800,000 Series A preferred shares and 2,000,000 Series B preferred shares, each with a stated capital of $25.00. The president and sole director of Nelson, Marc Boutet, is the owner of all of the issued and outstanding common shares. By July 31, 2007, Nelson had issued to investors 176,675 Series A preferred shares for an aggregate consideration of $4,416,925. During the subsequent fiscal year ended July 31, 2008, Nelson issued a further 172,545 Series A preferred shares and 27,080 Series B preferred shares. These shares were issued for an aggregate consideration of $4,672,383 net of share issue costs.

6 The preferred shares are non-voting and take priority over the common shares. The company's articles of amendment provide that the preferred shareholders are entitled to receive fixed preferential cumulative cash dividends at the rate of 10% per annum. Nelson had the unilateral right to redeem the shares on payment of the purchase price plus accrued dividends. At least one investor negotiated a right of redemption. Two redemption requests were outstanding as of the *CCAA* filing date.

7 As of the *CCAA* filing date of March 23, 2010, Nelson had issued and outstanding 585,916.6 Series A and Series B preferred shares with an aggregate stated capital of $14,647,914. The preferred shares are held by approximately 82 people. As of the date of filing of these *CCAA* proceedings, there were approximately $53,632 of declared but unpaid dividends outstanding with respect to the preferred shares and $73,652.51 of accumulated dividends.

8 Investors subscribing for preferred shares entered into subscription agreements described as term sheets. These were executed by the investor and by Nelson. Nelson issued share certificates to the investors and maintained a share register recording the name of each preferred shareholder and the number of shares held by each shareholder.

9 As reported by the Monitor, notwithstanding that Nelson issued two different series of preferred shares, the principal terms of the term sheets signed by the investors were almost identical and generally provided as follows:

- the issuer was Nelson;
- the par value was fixed at $25.00;
- the purpose was to finance Nelson's business operations;
- the dividend was 10% per annum, payable monthly, commencing one month after the investment was made;
- preferred shareholders were eligible for a dividend tax credit;
- Nelson issued annual T-3 slips on account of dividend income to the preferred shareholders;
- the preferred shares were non-voting (except where voting as a class was required), redeemable at the option of Nelson and ranked ahead of common shares; and
- dividends were cumulative and no dividends were to be paid on common shares if preferred share dividends were in arrears.

10 In addition, the Series B term sheet provided that the monthly dividend could be reinvested pursuant to a Dividend Reinvestment Plan ("DRIP").

11 The preferred shareholders were entered on the share register and received share certificates. They were treated as equity in the company's financial statements. Dividends were received by the preferred shareholders and they took the benefit of the advantageous tax treatment.

(c) Insolvency

12 Mr. Boutet knew that Nelson was insolvent since at least its financial year ended July 31, 2007. Nelson did not provide financial statements to any of the preferred shareholders prior to, or subsequent to, the making of the investment.

(d) Ontario Securities Commission

13 On May 12, 2010, the Ontario Securities Commission ("OSC") issued a Notice of Hearing and Statement of Allegations alleging that Nelson and its affiliate, Nelson Investment Group Ltd., and various officers and directors of those corporations committed breaches of the *Ontario Securities Act* in the course of selling preferred shares. The allegations include noncompliance with the prospectus requirements, the sale of shares in reliance upon exemptions that were inapplicable, the sale of shares to persons who were not accredited investors, and fraudulent and negligent misrepresentations made in the course of the sale of shares. The OSC hearing has been scheduled for the end of February, 2011.

(e) Legal Opinion

14 Based on the Monitor's review, the preferred shareholders were documented as equity on Nelson's books and records and financial statements. Pursuant to court order, the Monitor retained Stikeman Elliott LLP as independent counsel to provide an opinion on the characterization of the claims and potential claims of the preferred shareholders. The opinion concluded that the claims were equity claims. The Monitor posted the opinion on its website and also advised the preferred shareholders of the opinion and conclusions by letter. The opinion was not to constitute evidence, issue estoppel or res judicata with respect to any matters of fact or law referred to therein. The opinion, at least in part, informed Nelson's position which was supported by the Monitor, that independent counsel for the preferred shareholders was unwarranted in the circumstances.

(f) Development of Plan

15 The Monitor reported in its Eighth Report that a plan is in the process of being developed and that preferred shareholders would have their existing preference shares cancelled and would then be able to claim a tax loss on their investment or be given a new form of preference shares with rights to be determined.

Motion

16 The holders of promissory notes are represented by Representative Counsel appointed pursuant to my order of June 15, 2010. Representative Counsel wishes to have some clarity as to the characterization of the preferred shareholders' claims. Accordingly, Representative Counsel has brought a motion for an order that all claims and potential claims of the preferred shareholders against Nelson be classified as equity claims within the meaning of the *CCAA*. In addition, Representative Counsel requests that the unsecured creditors, which include the noteholders, be entitled to be paid in full before any claim of a preferred shareholder and that the preferred shareholders form a separate class that is not entitled to vote at any meeting of creditors. Nelson and the Monitor support the position of Representative Counsel. The OSC is unopposed.

17 On the return of the motion, some preferred shareholders were represented by counsel from Templeman Menninga LLP and some were self-represented. It was agreed that the letters and affidavits of preferred shareholders that were filed with the court would constitute their evidence. Oral submissions were made by legal counsel and by approximately eight individuals. They had many complaints. Their allegations against Nelson and Mr. Boutet range from theft, fraud, misrepresentation including promises that their funds would be secured, operation of a Ponzi scheme, breach of trust,

dividend payments to some that exceeded the rate set forth in Nelson's articles, conversion of notes into preferred shares at a time when Nelson was insolvent, non-disclosure, absence of a prospectus or offering memorandum disclosure, oppression, violation of section 23(3) of the *OBCA* and of the *Securities Act* such that the issuance of the preferred shares was a nullity, and breach of fiduciary duties.

18 The stories described by the investors are most unfortunate. Many are seniors and pensioners who have invested their savings with Nelson. Some investors had notes that were rolled over and replaced with preference shares. Mr. McVey alleges that he made an original promissory note investment which was then converted arbitrarily and without his knowledge into preference shares. He alleges that the documents effecting the conversion did not contain his authentic signature.

19 Mr. Styles states that he and his company invested approximately $4.5 million in Nelson. He states that Mr. Boutet persuaded him to convert his promissory notes into preference shares by promising a 13.75% dividend rate, assuring him that the obligation of Nelson to repay would be treated the same or better than the promissory notes, and that they would have the same or a priority position to the promissory notes. He then received dividends at the 13.75% rate contrary to the 10% rate found in the company's articles. In addition, at the time of the conversion, Nelson was insolvent.

20 In brief, Mr. Styles submits that:

(a) the investment transactions were void because there was no prospectus contrary to the provisions of the *Securities Act* and the Styles were not accredited investors; the preferred shares were issued contrary to section 23(3) of the *OBCA* in that Nelson was insolvent at the relevant time and as such, the issuance was a nullity; and the conduct of the company and its principal was oppressive contrary to section 248 of the *OBCA*; and that

(b) the Styles' claim is in respect of an undisputed agreement relating to the conversion of their promissory notes into preferred shares which agreement is enforceable separate and apart from any claim relating to the preferred shares.

The Issue

21 Are any of the claims advanced by the preferred shareholders equity claims within section 2 of the *CCAA* such that they are to be placed in a separate class and are subordinated to the full recovery of all other creditors?

The Law

22 The relevant provisions of the *CCAA* are as follows.

Section 2 of the *CCAA* states:

In this Act,

"Claim" means any indebtedness, liability or obligation of any kind that would be a claim provable within the meaning of section 2 of the *Bankruptcy and Insolvency Act*;

"Equity Claim" means a claim that is in respect of an equity interest, including a claim for, among others,

(a) a dividend or similar payment,

(b) a return of capital,

(c) a redemption or retraction obligation,

(d) a monetary loss resulting from the ownership, purchase or sale of an equity interest or from the rescission, or, in Quebec, the annulment, of a purchase or sale of an equity interest, or

(e) contribution or indemnity in respect of a claim referred to in any of paragraphs (a) to (d);"

"Equity Interest" means

(a) in the case of a corporation other than an income trust, a share in the corporation — or a warrant or option or another right to acquire a share in the corporation — other than one that is derived from a convertible debt, and

(b) in the case of an income trust, a unit in the income trust — or a warrant or option or another right to acquire a unit in the income trust — other than one that is derived from a convertible debt;

Section 6(8) states:

No compromise or arrangement that provides for the payment of an equity claim is to be sanctioned by the court unless it provides that all claims that are not equity claims are to be paid in full before the equity claim is to be paid.

Section 22.1 states:

Despite subsection 22(1) creditors having equity claims are to be in the same class of creditors in relation to those claims unless the court orders otherwise and may not, as members of that class, vote at any meeting unless the court orders otherwise.

23 Section 2 of the *Bankruptcy and Insolvency Act* ("*BIA*") which is referenced in section 2 of the *CCAA* provides that a claim provable includes any claim or liability provable in proceedings under the Act by a creditor. Creditor is then defined as a person having a claim provable as a claim under the Act.

24 Section 121(1) of the *BIA* describes claims provable. It states:

All debts and liabilities, present or future, to which the bankrupt is subject on the day on which the bankrupt becomes bankrupt or to which the bankrupt may become subject before the bankrupt's discharge by reason of any obligation incurred before the day on which the bankrupt becomes bankrupt shall be deemed to be claims provable in proceedings under this Act.

25 Historically, the claims and rights of shareholders were not treated as provable claims and ranked after creditors of an insolvent corporation in a liquidation. As noted by Laskin J.A. in *Central Capital Corp., Re* [2], on the insolvency of a company, the claims of creditors have always ranked ahead of the claims of shareholders for the return of their capital. This principle is premised on the notion that shareholders are understood to be higher risk participants who have chosen to tie their investment to the fortunes of the corporation. In contrast, creditors choose a lower level of exposure, the assumption being that they will rank ahead of shareholders in an insolvency. Put differently, amongst other things, equity investors bear the risk relating to the integrity and character of management.

26 This treatment also has been held to encompass fraudulent misrepresentation claims advanced by a shareholder seeking to recover his investment: *Blue Range Resource Corp., Re* [3] In that case, Romaine J. held that the alleged loss derived from and was inextricably intertwined with the shareholder interest. Similarly, in the United States, the Second Circuit Court of Appeal in *Matter of Stirling Homex Corp.* [4] concluded that shareholders, including those who had allegedly been defrauded, were subordinate to the general creditors when the company was insolvent. The Court stated that "the real party against which [the shareholders] are seeking relief is the body of general creditors of their corporation. Whatever relief may be granted to them in this case will reduce the percentage which the general creditors will ultimately realize upon their claims." *National Bank of Canada v. Merit Energy Ltd.* [5] and *EarthFirst Canada Inc., Re* [6] both treated claims relating to agreements that were collateral to equity claims as equity claims. These cases dealt with separate indemnification agreements and the issuance of flow through shares. The separate agreements and the ensuing claims

were treated as part of one integrated transaction in respect of an equity interest. The case law has also recognized the complications and delay that would ensue if *CCAA* proceedings were mired in shareholder claims.

27 The amendments to the *CCAA* came into force on September 18, 2009. It is clear that the amendments incorporated the historical treatment of equity claims. The language of section 2 is clear and broad. Equity claim means a claim in respect of an equity interest and includes, amongst other things, a claim for rescission of a purchase or sale of an equity interest. Pursuant to sections 6(8) and 22.1, equity claims are rendered subordinate to those of creditors.

28 The Nelson filing took place after the amendments and therefore the new provisions apply to this case. Therefore, if the claims of the preferred shareholders are properly characterized as equity claims, the relief requested by Representative Counsel in his notice of motion should be granted.

29 Guidance on the appropriate approach to the issue of characterization was provided by the Ontario Court of Appeal in *Central Capital Corp., Re* [7] . Central Capital was insolvent and sought protection pursuant to the provisions of the *CCAA*. The appellants held preferred shares of Central Capital. The shares each contained a right of retraction, that is, a right to require Central Capital to redeem the shares on a fixed date and for a fixed price. One shareholder exercised his right of retraction and the other shareholder did not but both filed proofs of claim in the *CCAA* proceedings. In considering whether the two shareholders had provable debt claims, Laskin J.A. considered the substance of the relationship between the company and the shareholders. If the governing instrument contained features of both debt and equity, that is, it was hybrid in character, the court must determine the substance of the relationship between the company and the holder of the certificate. The Court examined the parties' intentions.

30 In *Central Capital*, Laskin J.A. looked to the share purchase agreements, the conditions attaching to the shares, the articles of incorporation and the treatment given to the shares in the company's financial statements to ascertain the parties' intentions and determined that the claims were equity and not debt claims.

31 In this case, there are characteristics that are suggestive of a debt claim and of an equity claim. That said, in my view, the preferred shareholders are, as their description implies, shareholders of Nelson and not creditors. In this regard, I note the following.

(a) Investors were given the option of investing in promissory notes or preference shares and opted to invest in shares. Had they taken promissory notes, they obviously would have been creditors. The preference shares carried many attractions including income tax advantages.

(b) The investors had the right to receive dividends, a well recognized right of a shareholder.

(c) The preference share conditions provided that on a liquidation, dissolution or winding up, the preferred shareholders ranked ahead of common shareholders. As in *Central Capital Corp.*, it is implicit that they therefore would rank behind creditors.

(d) Although I acknowledge that the preferred shareholders did not receive copies of the financial statements, nonetheless, the shares were treated as equity in Nelson's financial statements and in its books and records.

32 The substance of the arrangement between the preferred shareholders and Nelson was a relationship based on equity and not debt. Having said that, as I observed in *I. Waxman & Sons Ltd., Re* [8] , there is support in the case law for the proposition that equity may become debt. For instance, in that case, I held that a judgment obtained at the suit of a shareholder constituted debt. An analysis of the nature of the claims is therefore required. If the claims fall within the parameters of section 2 of the *CCAA*, clearly they are to be treated as equity claims and not as debt claims.

33 In this case, in essence the claims of the preferred shareholders are for one or a combination of the following:

(a) declared but unpaid dividends;

(b) unperformed requests for redemption;

(c) compensatory damages for the loss resulting in the purchased preferred shares now being worthless and claimed to have been caused by the negligent or fraudulent misrepresentation of Nelson or of persons for whom Nelson is legally responsible; and

(d) payment of the amounts due upon the rescission or annulment of the purchase or subscription for preferred shares.

34 In my view, all of these claims fall within the ambit of section 2, are governed by sections 6(8) and 22.1 of the *CCAA*, and therefore do not constitute a claim provable for the purposes of the statute. The language of section 2 is clear and unambiguous and equity claims include "a claim that is in respect of an equity interest" and a claim for a dividend or similar payment and a claim for rescission. This encompasses the claims of all of the preferred shareholders including the Styles whose claim largely amounts to a request for rescission or is in respect of an equity interest. The case of *National Bank of Canada v Merit Energy Ltd.*[9] is applicable in regard to the latter. In substance, the Styles' claim is for an equity obligation. At a minimum, it is a claim in respect of an equity interest as described in section 2 of the CCAA. Parliament's intention is clear and the types of claims advanced in this case by the preferred shareholders are captured by the language of the amended statute. While some, and most notably Professor Janis Sarra[10], advocated a statutory amendment that provided for some judicial flexibility in cases involving damages arising from egregious conduct on the part of a debtor corporation and its officers, Parliament opted not to include such a provision. Sections 6(8) and 22.1 allow for little if any flexibility. That said, they do provide for greater certainty in the appropriate treatment to be accorded equity claims.

35 There are two possible exceptions. Mr. McVey claims that his promissory note should never have been converted into preference shares, the conversion was unauthorized and that the signatures on the term sheets are not his own. If Mr. McVey's evidence is accepted, his claim would be qua creditor and not preferred shareholder. Secondly, it is possible that monthly dividends that may have been lent to Nelson by Larry Debono constitute debt claims. The factual record on these two possible exceptions is incomplete. The Monitor is to investigate both scenarios, consider a resolution of same, and report back to the court on notice to any affected parties.

36 Additionally, the claims procedure will have to be amended. The Monitor should consider an appropriate approach and make a recommendation to the court to accommodate the needs of the stakeholders. The relief requested in the notice of motion is therefore granted subject to the two aforesaid possible exceptions.

Motion granted.

Footnotes

1 The Monitor is aware of six preferred shareholders with dividends that ranged from 10.5% to 13.75% per annum.

2 (1996), 38 C.B.R. (3d) 1 (Ont. C.A.).

3 (2000), 15 C.B.R. (4th) 169 (Alta. Q.B.).

4 (1978), 579 F.2d 206 (U.S. 2nd Cir. N.Y.).

5 2001 CarswellAlta 913 (Alta. Q.B.), aff'd 2002 CarswellAlta 23 (Alta. C.A.).

6 2009 CarswellAlta 1069 (Alta. Q.B.).

7 Supra, note 2.

8 2008 CarswellOnt 1245 (Ont. S.C.J. [Commercial List]).

9 Supra, note 5.

10 "From Subordination to Parity: An International Comparison of Equity Securities Law Claims in Insolvency Proceedings" (2007) 16 Int. Insolv. Re., 181.

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1996 CarswellOnt 316
Ontario Court of Appeal

Central Capital Corp., Re

1996 CarswellOnt 316, [1996] O.J. No. 359, 132 D.L.R. (4th) 223, 26 B.L.R. (2d) 88, 27 O.R. (3d) 494, 38 C.B.R. (3d) 1, 61 A.C.W.S. (3d) 18, 88 O.A.C. 161

Re CENTRAL CAPITAL CORPORATION; Re Companies' Creditors Arrangement Act, R.S.C. 1985, c. C-36, as amended

Re appeal from disallowance of claims of JAMES W. McCUTCHEON, CENTRAL GUARANTEE TRUST COMPANY, as trustee for Registered Retirement Savings Plan of JAMES W. McCUTCHEON and CONSOLIDATED S.Y.H. CORPORATION by PEAT MARWICK THORNE INC., Administrator of certain assets of CENTRAL CAPITAL CORPORATION

ROYAL BANK OF CANADA, BANCA COMMERCIALE ITALIANA OF CANADA, CREDIT LYONNAIS CANADA, DAI-ICHI KANGYO BANK (CANADA), PRUDENTIAL ASSURANCE COMPANY LIMITED, PRUDENTIAL GLOBAL FUNDING, INC., SANWA BANK CANADA, BANK OF TOKYO CANADA, TORONTO-DOMINION BANK, WESTDEUTSCHE LANDESBANK GIROZENTRALE, BACOB SAVINGS BANK s.c., BANCA NAZIONALE DEL LAVORO OF CANADA, BANCO DI ROMA (LONDON), COMMERZBANK INTERNATIONAL S.A., CREDIT COMMERCIAL DE FRANCE, CREDIT COMMUNAL DE BELGIQUE S.A., CREDIT SUISSE (LUXEMBOURG) S.A., DG BANK LUXEMBOURG S.A., KREDIETBANK NV (BELGIUM), NIPPON TRUST BANK LIMITED, OLFRN INVESTMENT (PANAMA) INC., PAUL REVERE LIFE INSURANCE, RBC FINANCE B.V., SCOR REINSURANCE COMPANY OF CANADA, SOCIÉTÉ GÉNÉRALE, BANK OF TOKYO, LTD., CHIBA BANK LTD., DAI-ICHI KANGYO BANK, LTD. (ATLANTA), HOKURIKU BANK LTD., JOROKU BANK LTD., KYOWA SAITAMA BANK (CHICAGO), LAURENTIAN BANK OF CANADA, LAURENTIAN GROUP CORPORATION AND IMPERIAL LIFE ASSURANCE COMPANY OF CANADA, LONG-TERM CREDIT BANK OF JAPAN, LTD., MARITIME LIFE ASSURANCE COMPANY, MITSUBISHI TRUST AND BANKING CORPORATION, SANWA BANK, LIMITED (LONDON), SHOKO CHUKIN BANK (NEW YORK) and TOHO BANK, LTD. v. CENTRAL CAPITAL CORPORATION

Finlayson, Weiler and Laskin JJ.A.

Heard: August 17, 1995
Judgment: February 7, 1996
Docket: Docs. CA C21479, C21477

Counsel: *Bryan Finlay, Q.C.*, and *John M. Buhlman*, for James W. McCutcheon and Central Guaranty Trust.
James H. Grout and *Anne Sonnen*, for Consolidated S.Y.H. Corporation.
Terence J. O'Sullivan and *Paul G. Macdonald*, for unsecured creditors of Central Capital Corporation.
Neil C. Saxe, for Peat Marwick Thorne Inc.

Subject: Corporate and Commercial; Insolvency

Headnote

Corporations — Arrangements and compromises — Companies' Creditors Arrangement Act — Claims — Preferred shares having right of retraction — Company unable to redeem shares because of insolvency — Preferred shareholders claiming that right constituted debt and claim provable — Administrator denying claims and decision upheld on appeal — Preferred shareholders having no claim under plan of arrangement — Further appeal dismissed — Companies' Creditors Arrangement Act, R.S.C. 1985, c. C-36.

An order was made declaring that the *Companies' Creditors Arrangement Act* applied to CCC and staying all proceedings against CCC. Under the reorganization, the most valuable assets of CCC were transferred to a new company. CCC's creditors were entitled to receive shares and debentures in the new company to reflect some of their outstanding debt. The balance of the debt and equity claimants, including the shareholders of CCC, received common shares in CCC, which now lacked its most valuable assets.

Some of the preferred shares had a right of retraction. The preferred shareholders argued that the right of retraction constituted a future contingent liability of CCC and was, therefore, a debt provable in bankruptcy. Even though CCC was prohibited by its insolvency from making payments to redeem the shares, it was not relieved of its obligation to redeem. The administrator denied their claims, and the preferred shareholders appealed. Their appeals were dismissed upon a finding that the preferred shares remained shares until they were redeemed; therefore, the preferred shareholders were not creditors and had no claims provable.

The preferred shareholders appealed.

Held:

The appeals were dismissed.

Per Finlayson J.A. (dissenting)

The preferred shares were the equivalent of vendor shares because they were received in exchange for the transfer of assets to CCC. By deferring the realization of the purchase price of their assets to the agreed dates, the preferred shareholders extended credit to CCC. In return for extending credit, the preferred shareholders agreed to receive dividends calculated in advance, but payable when declared by the board of directors. Therefore the substance of the transaction created a debt owed to the preferred shareholders. The fact that the preferred shareholders had rights as shareholders in CCC up to the time when the retraction clauses were exercisable did not affect their right to enforce payment of the retraction price when it became due. There was no reason why the preferred shareholders should not be treated as both shareholders and creditors.

Per Weiler J.A.

The trial judge was correct in determining that the relationship between the shareholders and CCC was a shareholder relationship. The shareholders continued to be shareholders after the retraction date and remained shareholders at the time of CCC's reorganization. The preferred shares were part of CCC's capital and were always shown as shareholders' equity on CCC's books.

Under s. 36 of the *Canada Business Corporations Act*, a corporation's ability to redeem its redeemable shares is subject to its articles and a solvency requirement. CCC's articles provided for the redemption of all preferred shares on or after the retraction date; however, they stated that the redemption could be carried out only if not "contrary to law." Because CCC could not comply with the solvency requirements of s. 36 on the retraction date, any redemption would be "contrary to law." Therefore, CCC's obligation to redeem its shares was not absolute.

Although there was a right to receive payment, the effect of the solvency provision meant that there was no right to enforce payment. Therefore, the promise to pay the amount owing on the shares in the retraction provision was not one that could be proved as a claim. The retraction amounts did not constitute a debt or liability within the meaning of s. 121 of the *Bankruptcy and Insolvency Act*.

Per Laskin J.A. (concurring)

The relationship between the preferred shareholders and CCC had the characteristics of both debt and equity; however, in substance the preferred shareholders were shareholders and not creditors of CCC. Neither the existence nor the exercise of the retraction rights turned them into creditors. The preferred shareholders agreed to take preferred shares instead of another type of instrument, such as a bond or debenture, which clearly would have made them creditors. There was no evidence to support the preferred shareholders' contention that by taking the preferred shares they were extending credit to CCC by deferring payment of the purchase price. Further, the shares were recorded in the financial statements of CCC as "capital stock". The amount CCC might be required to pay upon the preferred shareholders' exercise of their retraction rights was not recorded as debt.

Under s. 36(2) of the *Canada Business Corporations Act*, an insolvent corporation is prohibited from redeeming shares. Further, the share conditions attached to the preferred shareholders' shares provided that they could not be redeemed if to do so would be "contrary to applicable law", that being s. 36(2) in this case. To find that the preferred shareholders had provable claims would defeat the purpose of s. 36(2).

Table of Authorities

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By Finlayson J.A. (dissenting)

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East Chilliwack Agricultural Co-op., Re (1989), 42 B.L.R. 236, 74 C.B.R. (N.S.) 1, 58 D.L.R. (4th) 11 (B.C. C.A.) — *considered*

Exchange Banking Co., Re; Flitcroft's Case (1882), 21 Ch. D. 519 (C.A.) — *referred to*

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s. 2 "claim provable in bankruptcy"

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s. 2 "creditor"

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s. 191(7)

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

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Fraudulent Conveyances Act, R.S.O. 1990, c. F.29.

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Appeals from judgment reported at (1995), 29 C.B.R. (3d) 33, 22 B.L.R. (2d) 210 (Ont. Gen. Div. [Commercial List]) dismissing appeals from denial of claims by administrator under *Companies' Creditors Arrangement Act* plan of reorganization.

***Finlayson J.A.* (dissenting):**

1 The appellant James W. McCutcheon and Central Guarantee Trust Company as Trustee for the Registered Retirement Savings Plan of James W. McCutcheon (hereinafter sometimes referred to collectively as "McCutcheon") and the appellant Consolidated S.Y.H. Corporation ("SYH") appeal from the order of The Honourable Madam Justice Feldman of the Ontario Court (General Division) dated January 9, 1995 [reported at 29 C.B.R. (3d) 33]. Feldman J. dismissed appeals from decisions dated January 20, 1993 and February 16, 1993 of the respondent Peat Marwick Thorne Inc., in its capacity as Interim Receiver, Manager and Administrator ("Administrator") of certain assets of Central Capital Corporation ("Central Capital"). The Administrator disallowed Proofs of Claim submitted by the appellants with respect to a Plan of Arrangement under the *Companies' Creditors Arrangement Act*, R.S.C. 1985, c. C-36 ("*CCAA*"). Leave to appeal the order of Feldman J. was granted on March 17, 1995 by The Honourable Mr. Justice Houlden.

Overview of the Proceedings

2 These appeals arise out of the insolvency of Central Capital which in and prior to December 1991 defaulted under its obligations to various unsecured lenders, note holders and subordinated debt holders. In early December of 1991,

Central Capital advised its creditors that, pending implementation of new financial arrangements, it had decided to discontinue payment of all interest and principal due under outstanding loans, with the exception of indebtedness due under secured notes issued to The Royal Trust Company. In an Agreed Statement of Facts, which was prepared by the parties for the purposes of appeals from the disallowances of the Administrator, it was agreed that at all material times since in or prior to December 1991, Central Capital was insolvent. It had a total unsecured debt of $1,577,359,000 and, among other things:

(a) it was unable to pay its liabilities as they became due; and

(b) the realizable value of its assets was less than the aggregate of its liabilities.

3 By Notice of Application issued June 12, 1992, thirty-nine of the creditors commenced an application pursuant to the *CCAA* for an order declaring the following: that Central Capital was a debtor company to which the *CCAA* applied; that Peat Marwick Thorne Inc. be appointed Administrator of the property, assets and undertaking of Central Capital; that a stay of proceedings against Central Capital, except with leave of the court, be granted and; that the applicants be authorized and permitted to file a plan of compromise or arrangement under the *CCAA*.

4 By order of Houlden J. made June 15, 1992, Central Capital was declared to be a company to which the *CCAA* applied and all proceedings against Central Capital were stayed. By further order of Houlden J. made July 9, 1992, it was provided, among other things, that:

(a) Peat Marwick Thorne Inc. was appointed Administrator, Interim Receiver and Manager of such of the undertaking, property and assets of Central Capital as necessary for the pur pose of effecting the transaction described in the order pursuant to which specified significant assets of Central Capital would be transferred to a newly incorporated company called Canadian Insurance Group Limited ("CIGL");

(b) the Administrator was authorized to enter into and carry out a Subscription and Escrow Agreement with creditors of Central Capital pursuant to which creditors of Central Capital would be entitled to elect to exchange a portion of the indebtedness owing to them by Central Capital for shares and debentures to be issued by CIGL;

(c) the Administrator was authorized and directed to supervise the calling for claims of creditors of Central Capital who elected to exchange a portion of the indebtedness from Central Capital for shares and debentures to be issued by CIGL as aforesaid; and

(d) Central Capital was authorized and permitted to file with the court a formal plan of compromise or arrangement with Central Capital's secured and unsecured creditors and shareholders in accordance with the *CCAA* and the *Canada Business Corporations Act*, R.S.C. 1985, c. C-44 (the "*CBCA*"), which would provide for the restructuring and reorganization of the debt and equity of Central Capital in the manner set out in the said order.

5 According to the Agreed Statement of Facts, the order of Houlden J. was made without prejudice to the rights of the appellants to assert claims as creditors in the CIGL transaction. Pursuant to the terms of the July 9, 1992 order, all claims of creditors of Central Capital who wished to participate in CIGL were required to be submitted to the Administrator by September 8, 1992, or such other date fixed by the court. The Administrator received claims from various persons who wished to participate, including the claims submitted by the appellants herein.

6 The Administrator disallowed the claims of McCutcheon and SYH by Notices of Disallowance dated January 20, 1993 and February 16, 1993 in which various reasons were cited as to why the appellants did not qualify as creditors. The effect of this disallowance was that McCutcheon and SYH could participate only as shareholders in the plan of compromise and arrangement under the *CCAA* to be put forward by Central Capital. In dismissing the appeals from this disallowance, Feldman J. found that the appellants were not creditors because they did not have a claim provable under the *Bankruptcy Act* (Canada), R.S.C. 1985, c. B-3 ("*Bankruptcy Act*").

Issue

7 The Agreed Statements of Facts set out the issue in the appeal in the following language:

> Do the appellants, or any of them, have claims provable against CCC [Central Capital] within the meaning of the *Bankruptcy Act (Canada)*, as amended as of the date of the Restated Subscription and Escrow Agreement? If the appellants, or any of them, have provable claims, then the proof of claim of any appellant that has a claim provable is to be allowed as filed and the appeal from the disallowance allowed, and the appellants, or any of them, whose claim is allowed, are to participate in the Plan of Arrangement of Central Capital as a senior creditor.

8 The determination of this issue was deferred by Houlden J.'s order of October 27th, 1992. He ordered therein that preferred shareholders who had filed claims against Central Capital as creditors were not permitted to vote at the meeting of creditors called to consider the Plan of Arrangement "... but such is without prejudice to the rights of those claimants to prosecute their claims as filed". The last paragraph in the order ended:

> For greater certainty, the validity of any claim filed by a preferred shareholder shall not be affected by the terms of this paragraph.

Overview of the Restructuring of Central Capital

9 The order of Houlden J. of July 9, 1992 directed the restructuring of Central Capital under the *aegis* of the court. The order, and others that would follow, contemplated that the restructuring would take place in two stages. The first stage involved the transfer to the Administrator of certain major assets of Central Capital to a company to be incorporated called Central Insurance Group Limited (CIGL). This company is frequently referred to in the documentation and the reasons of Feldman J. as "Newco". CIGL was then to be owned by those Central Capital creditors who chose to participate in the reorganization by accepting a reduction in their debts due from Central Capital and exchanging this reduced indebtedness for debentures in CIGL. Subscription for debentures by this means additionally entitled the creditors to subscribe for shares in CIGL. Our understanding from counsel is that the assets transferred to CIGL included the assets acquired by Central Capital from the appellant in purchase agreements described later in these reasons.

10 The court approved a Subscription and Escrow Agreement setting out this arrangement. In order to participate, the creditors were required to file with the Administrator of Proof of Claim in the prescribed form along with other documents confirming the creditor's intention to reduce its claim against Central Capital and to subscribe for debentures and shares of CIGL. Claims were to be based on Central Capital's indebtedness to creditors as of June 15, 1992, the date of the court-ordered stay of proceedings. This transaction was completed on October 1, 1992 and resulted in CIGL being owned by the creditors of Central Capital in exchange for a reduction in Central Capital's unsecured debt in the amount of $603,000.000.

11 The second stage of the restructuring involved a Plan of Arrangement under the *CCAA*. That plan as put forward by Central Capital recognized four classes of creditors, only one of which, namely that of "Senior Creditors", could apply to the appellants. The Plan of Arrangement, as amended, provided that Central Capital would issue to Senior Creditors *pro rata* on the basis of their senior claims of secured promissory notes in the aggregate principal amount of $20,000,000 of secured debt, which were to be known as first secured notes. A similar arrangement was made for the issuance of $1,000,000 of second secured promissory notes to subordinated creditors. Senior and subordinated creditors included any creditor whose claim had been allowed under the CIGL claims procedure in the first stage, to the extent of that creditor's reduced claim.

12 The Plan of Arrangement also called for the creation of a new class of shares in Central Capital to be called the Central New Common Shares. Central Capital would issue to the above Senior and Subordinated Creditors ninety percent of the new share capital of Central Capital in extinguishment of the balance of their debt. The Central Capital

shareholders of all classes would have their existing shares converted into the remaining ten percent of the Central New Common Shares. All of the existing preferred and common shares would be cancelled upon implementation of the plan.

13 The amended Plan of Arrangement was ultimately voted on and approved by all four classes of creditors of Central Capital. On December 18, 1992, Houlden J. sanctioned this plan of arrangement under the *CCAA*. He authorized and directed Central Capital to apply for Articles of Reorganization pursuant to s. 191 of the *CBCA*, so as to authorize the creation of the Central New Common Shares for implementation of the amended Plan of Arrangement. He also lifted the stays of proceedings affecting Central Capital and its ability to carry on business as of January 1, 1993.

14 The effect of the amended Plan of Arrangement after approval was that all remaining debts and obligations owed by Central Capital to its creditors on or before June 15, 1992 were extinguished and all outstanding and unissued shares of any kind in Central Capital were cancelled and replaced by Central New Common Shares. Central Capital was then free to carry on business. It was no longer insolvent.

Facts as They Relate to the Claim of McCutcheon

15 By a Share Purchase Agreement dated June 15, 1987 between Central Capital and Gormley Investments Limited ("Gormley") and Heathley Investments Limited ("Heathley"), Central Capital agreed to purchase all Class "B" Voting Shares of Canadian General Securities Limited ("CGS") that were owned by Gormley and Heathley. James W. McCutcheon and his brother, who were the sole shareholders of Gormley, represented to Central Capital that CGS owned substantially all of the shares of Canadian Insurance Sales Limited, which in turn owned substantially all of the shares in a number of operating insurance, credit and trust companies. The consideration for the purchase of the CGS shares was $575 per share. The vendors were to be paid $400 per share in cash on closing and were to receive seven Series B Senior Preferred Shares of Central Capital. These shares contained a retraction clause entitling the holder to retract each preferred share on July 1, 1992 for $25. Failing issuance of the shares by Central Capital, the vendors were to receive an additional $175 for each CGS share. The Share Purchase Agreement and later the Articles of Central Capital further provided that the holders of Series B Senior Preferred Shares were entitled to receive dividends as and when declared by the directors of Central Capital out of monies of the corporation properly applicable to the payment of dividends and in the amount of $1.90625 per share per annum (being 7 5/8% per annum on the stated capital of $25 per share) payable in equal quarterly payments. No dividends were in fact declared.

16 The Certificate of Amendment for Central Capital dated July 30, 1987, and the Articles of Amendment setting out the provisions attaching to the Series B Senior Preferred Shares contain all the terms and conditions governing the said shares. I am setting out below a description of those that are relevant to this appeal.

17 Pursuant to Article 4.1 of the Senior Series B Provisions, each holder of Series B Senior Preferred Shares was entitled, subject to and upon compliance with the provisions of Article 4, to require Central Capital to redeem all or any part of the Series B Senior Preferred Shares registered in the name of that holder on July 1, 1992 at a price equal to $25 per share, plus all accrued and unpaid dividends thereon, calculated to but excluding the Retraction Date.

18 Article 4.2 of the Senior Series B Provisions sets out the procedure for retraction of the shares. Article 4.3 of the Senior Series B Provisions provides that if the redemption by Central Capital of all of the Series B Senior Preferred Shares required to be redeemed on the Retraction Date would be contrary to applicable law or the rights, privileges, restrictions and conditions attaching to any shares of Central Capital ranking prior to Series B Senior Preferred Shares, then Central Capital shall redeem only the maximum number of Series B Senior Preferred Shares which it determined was permissible to redeem at that time. Article 4.3 provides the mechanism for a *pro rata* redemption from each holder of the tendered Series B Senior Preferred Shares and redemption of the tendered Series B Senior Preferred Shares by Central Capital at further dates.

19 Article 4.4(a) provides that subject to Section 4.4(b), the election of any holder to require Central Capital to redeem any Series B Senior Preferred Shares shall be irrevocable upon receipt by the transfer agent of the Certificates for the shares to be redeemed and the signification of election of the holder of the Series B Senior Preferred Shares.

20 Article 4.4(b) of the Senior Series B Provisions provides that if the retraction price is not paid by Central Capital, Central Capital shall forthwith notify each holder of the Series B Senior Preferred Shares who has not received payment for his deposited shares of the holder's right to require Central Capital to return all (but not less than all) of the holder's deposited Share Certificates and the holder's rights under Article 4.3 outlined above.

21 Article 4.5 of the Senior Series B Provisions provides that the inability of Central Capital to effect a redemption shall not affect or limit the obligation of Central Capital to pay any dividends accrued or accruing on the Series B Senior Preferred Shares from time to time not redeemed and remaining outstanding.

22 Article 7 of the Series Senior B Provisions provides that in the event of the liquidation, dissolution or winding-up of Central Capital, whether voluntary or involuntary, or any other distribution of assets of Central Capital among its shareholders for the purposes of winding up its affairs, the holders of the Series B Senior Preferred Shares shall be entitled to receive, from the assets of Central Capital, $25 per Series B Senior Preferred Shares, plus all accrued and unpaid dividends thereon, to be paid prior to payment to junior ranking shareholders. Upon payment of such amounts, the holders of the Series B Senior Preferred Shares shall not be entitled to share in any further distribution of assets of Central Capital.

23 A Notice of Retraction Privilege was sent by Central Capital to the holders of Series B Senior Preferred Shares with a cover letter dated April 23, 1992. The letter stated, among other things, that Central Capital would not redeem any shares because the redemption of such shares would be contrary to applicable law in the context of Central Capital's then current financial situation. McCutcheon and Central Guaranty Trust deposited for redemption 406,800 and 26,000 Series B Senior Preferred Shares, respectively, in accordance with the Senior Series B Provisions and the Notice of Retraction Privilege. The shares were deposited on May 28, 1992, with Montreal Trust Company of Canada, pursuant to the Notice of Retraction Privilege. The shares were properly tendered for redemption in the manner and within the time required by Central Capital's Articles of Amendment.

24 Central Capital did not pay the redemption price on July 1, 1992 and on July 20, 1992 it notified each holder of Series B Senior Preferred Shares of its right to require Central Capital to return all of the holder's deposited Share Certificates as required by Article 4.4(b) of the Senior Series B Provisions. McCutcheon and Central Guaranty Trust did not exercise that right.

25 Pursuant to the terms of Houlden J.'s order of July 9, 1992 directing the restructuring of Central Capital, McCutcheon submitted to the Administrator, as a creditor of Central Capital, Proofs of Claim dated September 3, 1992 and September 4, 1992, respectively. McCutcheon claimed the amount of $10,913,593.69 in respect of his Series B Senior Preferred Shares tendered for redemption. Central Guaranty Trust claimed the amount of $697,526.68 in respect of its tendered 26,000 Series B Senior Preferred Shares. McCutcheon also executed and submitted the Restated Subscription and Escrow Agreement and other documents electing to participate in CIGL. These claims were completed and submitted in the prescribed form and within the time required by Houlden J.'s order.

26 As was previously noted, these claims were disallowed by the Administrator. The substance of the Administrator's reasons for disallowance was that the ability of Central Capital to redeem these preference shares is restricted by the provisions of the *CBCA* and it would be contrary to applicable law to redeem the shares in the context of Central Capital's financial position. The relevant provision of the *CBCA* provides:

Redemption of shares.

36. (1) Notwithstanding subsection 34(2) or 35(3), but subject to subsection (2) and to its articles, a corporation may purchase or redeem any redeemable shares issued by it at prices not exceeding the redemption price thereof stated in the articles or calculated according to a formula stated in the articles.

Limitation.

(2) A corporation shall not make any payment to purchase or redeem any redeemable shares issued by it if there are reasonable grounds for believing that

(*a*) the corporation is, or would after the payment be, unable to pay its liabilities as they become due; or

(*b*) the realizable value of the corporation's assets would after the payment be less than the aggregate of

(i) its liabilities, and

(ii) the amount that would be required to pay the holders of shares that have a right to be paid, on a redemption or in a liquidation, rateably with or prior to the holders of the shares to be purchased or redeemed.

Evidently, the Administrator equated redemption by the corporation with the right of retraction by the preferred shareholder. It agreed with Central Capital's position that once it became insolvent in December of 1991, Central Capital no longer had the ability to redeem the shares tendered for retraction and thus McCutcheon was restricted to exercising what rights it might have as a shareholder.

Facts as They Relate to the Claim of SYH

27 Pursuant to an Agreement of Purchase and Sale made as of June 30, 1989, as amended, Scottish & York Holdings Limited (the predecessor to SYH) sold to Central Capital the shares of Central Canada Insurance Services Limited, Eaton Insurance Company, Scottish & York Insurance Co. Limited and Victoria Insurance Company of Canada (collectively the "Insurance Companies"), except for certain preference shares held by the directors of those corporations. In consideration of this transfer, Central Capital issued to Scottish & York Holdings Limited 60,116,000 Series A Junior Preferred Shares and 9,618,560 Series B Junior Preferred Shares.

28 The Articles of Central Capital provided that it would pay on each dividend payment date prior to the fifth anniversary of this issue, as and when declared by the directors out of the assets of the corporation properly applicable to the payment of dividends, a dividend of $.08 for each outstanding Series A Junior Preferred Share. The dividend was payable quarterly by the issuance of .02 Series Junior Preferred Shares for every outstanding Series A Junior Preferred Share. No dividends were in fact declared.

29 The Articles also provided that Central Capital was obligated to retract the Series A Junior Preferred Shares and Series B Junior Preferred Shares, at the option of the holders of those shares, on the fifth anniversary of their issuance. The retraction price was $1.00 per share plus all accrued and unpaid dividends. Payment of the retraction price of these shares by Central Capital was subject to the provisions of the *CBCA*, which governs the affairs of Central Capital. For the purposes of this appeal, I believe that we can treat the balance of the provisions relating to these preferred shares as being the same as those governing the McCutcheon Series B Senior Preferred Shares.

30 Given that the operative date for proving claims against Central Capital was June 15, 1992, the retraction date governing the preferred shares of SYH was some two years removed. Notwithstanding, on September 8, 1992 SYH executed and delivered to the Administrator a Proof of Claim, a Counterpart of the Restated Subscription and Escrow Agreement, an initial Share Subscription and an Instrument of Claims Reduction Form, all in the prescribed form and within the time required. The claim was that SYH was holding or entitled to hold the following shares of Central Capital:

(a) 60,116,000 Junior Preferred Series A shares;

(b) 9,618,560 Junior Preferred Series B shares;

(c) 4,611,095 Junior Preferred Series B shares accrued to June 15th, 1992 but not yet issued to SYH;

for a total of 74,345,655 shares, each having a retraction value of $1.00. However, because of some adjustments in favour of Central Capital to the purchase price of the shares sold by SYH to Central Capital under the June 30, 1989 Agreement of Purchase and Sale, the net claim as of June 15, 1992 was reduced from $74,345,655 to $72,388,836.

31 By Notice of Disallowance dated January 20, 1993, the Administrator disallowed the claim by SYH to subscribe for debentures and common shares to be issued by CIGL. The reasons for the disallowance are similar to those provided for disallowing the claims of McCutcheon. The Administrator found that SYH's right to require Central Capital to retract the Series A and B Junior Preferred Shares only arose on the expiry of the fifth anniversary of their issuance and that Central Capital was precluded from retracting those shares by virtue of its insolvency and the provisions of the *CBCA*. Hence SYH, like McCutcheon, was limited to exercising what other rights it might have as a shareholder.

Analysis

32 Although the factual groundwork is necessary for putting in perspective the sole issue before the court, the final question confronting us is a narrow one. Did the retraction clauses in the appellants' shares create a debt owed by Central Canada as of June 15, 1992 within the meaning of the *Bankruptcy Act*? I think that they did.

33 It is agreed that the operative section of the *Bankruptcy Act* is s. 121(1). It reads as follows:

> *121.*(1) All debts and liabilities, present or future, to which the bankrupt is subject at the date of the bankruptcy or to which he may become subject before his discharge by reason of any obligation in curred before the date of the bankruptcy shall be deemed to be claims provable in proceedings under this Act.

There was no bankruptcy in this case and thus the relevant date was agreed to be June 15, 1992. The obligations of Central Capital to the appellants were incurred before that date, and so the only question becomes whether the obligations created a debt between the appellants and Central Capital.

34 What then is a debt? All the parties turn to *Black's Law Dictionary*, quoting different editions. The following is from the Sixth Edition (1990), at p. 403:

> **Debt.**
>
> A sum of money due by certain and express agreement. A specified sum of money owing to one person from another, including not only the obligation of debtor to pay but right of creditor to receive and enforce payment. ...
>
> A fixed and certain obligation to pay money or some other valuable thing or things, either in the present or in the future.

35 The above is consistent with what is defined as a debt by *Jowitt's Dictionary of English Law*, 2nd ed. (1977), at p. 562:

> A debt exists when a certain sum of money is owing from one person (the debtor) to another (the creditor). Hence "debt" is properly opposed to unliquidated damages; to liability, when used in the sense of an inchoate or contingent debt; and to certain obligations not enforceable by ordinary process. "Debt" denotes not only the obligation of the debtor to pay, but also the right of the creditor to receive and enforce payment.

And finally, *The Shorter Oxford Dictionary*, 3rd ed. (1973), at p. 497:

> **Debt**

> *1.* That which is owed or due; anything (as money, goods or service) which one person is under obligation to pay or render to another.
>
> *2.* A liability to pay or render something; the being under such liability.

36 I have no difficulty in finding that the claims of the appellants in the case under appeal fall within all of the above definitions. As will be discussed herein, concern was expressed in this case over whether or not the appellants as creditors were entitled to "receive and enforce payment" on the "debt" because of the insolvency of Central Capital on June 15, 1992. I will deal with the specific arguments relating to the effect of insolvency on this particular indebtedness in due course, but for the moment I am content to observe that the above definitions contemplate only that the creditor's right to recover is the reciprocal of the debtor's obligation to pay. For every debtor there must be a creditor. There may be cases where it is difficult to identify the person who in law may receive and enforce payment, but this is not such a one.

37 With great respect to the judge of first instance and to the submissions of counsel for the unsecured creditors, I believe that the fundamental error that has been made in these proceedings arises from the conception that the preferred shares in question can either be debt instruments or equity participation instruments, but they cannot have the attributes of both. Feldman J. had this to say at p. 48 of her judgment:

> Although the right of retraction at the option of the preferred shareholder may be less common than the usual right of the company to redeem at its option, that right is one of the incidents or provisions attaching to the preferred shares, but does not change the nature of those shares from equity to debt. The parties have characterized the transaction as a share transaction. The court would require strong evidence that they did not intend that characterization in order to hold that they rather intended a loan.
>
> In my view, this case turns on whether the right of retraction itself creates a debt on the date the company becomes obligated to redeem even if it cannot actually redeem by payment on that date, or a contingent future debt on the same analysis, not on whether the preferred shares themselves with the right of retraction are actually debt documents.
>
> Because the preferred shares remain in place as shares until the actual redemption, the appellants are not creditors and have no claim provable under the *Bankruptcy Act* (Canada), and the appeals are therefore dismissed.

38 As I read these reasons, the learned judge is in effect stating that these instruments are preferred shares in the corporation because the parties have so described them. In the first place, I do not think that describing the documents as preferred shares is conclusive as to what instrument the parties thought they were creating. In the second place, it is not what the parties call the documents that is determinative of their identity, but rather it is what the facts require the court to call them. The character of the instrument is revealed by the language creating it and the circumstances of its creation. Although these instrument may "remain in place as shares" until they are actually redeemed, they also contain a specific promise to pay at a specified date. This is the language of debt. I cannot accept the proposition that a corporate share certificate cannot create a corporate debt in addition to the certificate holder's rights as a shareholder.

39 The rules relating to the competing rights of shareholders and creditors of an insolvent corporation have become so regulated by governmental action that one can readily lose sight of the common law basis for making a distinction. To understand the difference in treatment, we must re-examine what a share of a corporation represents. Initially, a share is issued by the corporation to raise share capital. The price of the share is money or the promise of money. Accordingly, an individual share is one of a number of separate but integral parts of the authorized capital of a corporation. Even though it is the shareholders who contribute to the capital of the corporation, the capital remains the property of the corporation. The shareholders, however, as owners of the shares of capital, effectively control the corporation. They have the responsibility of managing its affairs through their control over the board of directors and in popular terminology are considered to be the owners of the corporation. However, the corporation is a separate entity in law, and if in the course of carrying out its business it incurs debts to third parties, those debts are those of the corporation. A corporation is an

intangible and its capital therefore represents its substance to third parties having business dealings with the corporation. A preferred share is simply a share of a class of issued shares which contains a preference over other classes of shares, whether preferred or common: see Sutherland, *Fraser and Stewart on Company Law of Canada*, 6th ed. (1993), at pp. 157 and 195 for further discussion.

40 The rights of shareholders are conveniently summarized by R.M. Bryden in his chapter, "The Law of Dividends", contained in Ziegel ed., *Studies in Canadian Company Law* (1967), at p. 270:

> The purchaser of a share in a business corporation acquires three basic rights: he is entitled to vote at shareholders' meetings; he is entitled to share in the profits of the company when these are declared as dividends in respect of the shares of the class of which his share forms a part, and he is entitled, upon the winding-up of the corporation, to participate in the distribution of the assets of the company that remain after creditors are paid. A fourth right which should be noted is the right to transfer ownership in his share, whereby the owner for the time being may realize upon the increase in value of the company's assets, or its favourable prospects, by selling his share at a price reflecting the buyer's estimation of the value of the rights he will acquire. Unless the shareholder chooses to sell his share, he can realize a return upon his investment only through receipt of dividends or by the return of his capital upon an authorized reduction of capital or winding up.

41 Shareholders are variously characterized as entrepreneurs, investors or risktakers and as such they have the opportunities of benefitting from the successes of the corporation and suffering from its failures. While the corporation is an operating entity, the shareholders receive their rewards, if they are any, through the payment of dividends declared from time to time by the board of directors. While the source of these dividends is not restricted to surplus funds, the result of the payment of the dividend must not result in a return of capital to the shareholders. The classic justification for this rule was stated by Sir George Jessel, Master of the Rolls in *Re Exchange Banking Co.; Flitcroft's Case* (1882), 21 Ch. D. 519 (C.A.), at 533-4:

> The creditor has no debtor but that impalpable thing the corporation, which has no property except the assets of the business. The creditor ... gives credit to that capital, gives credit to the company on the faith of the representation that the capital shall be applied only for the purposes of the business, and he has therefore a right to say that the corporation shall keep its capital and not return it to the shareholders. ...

42 Creditors, on the other hand, do not have an ownership or equity interest in the corporation. They are third parties who have loaned money or otherwise advanced credit to the corporation. They look to the company for payment in accordance with the terms of the contract creating the indebtedness. They are also restricted in their recovery to the amounts stipulated in the terms of indebtedness. They are entitled to payment regardless of the financial circumstances of the debtor corporation and accordingly are not restricted to receiving payment of the debt from surplus. They can be paid out of assets or through the creation of further indebtedness. It is immaterial how the corporation records this indebtedness in its internal books. In some circumstances the indebtedness could properly reflect the acquisition of property from a creditor as a capital asset. This does not, however, convert the creditor into an investor. The vendor of the property remains a creditor and retains priority over shareholders in the event of a bankruptcy or insolvency.

43 In my view, the reasons under appeal do not reflect a sensitivity to the circumstances which gave rise to the issuance of the preference shares. The shares were not issued by Central Capital to the general public in order to raise capital and do not represent an investment by the public in the capital of the corporation. They were issued to specific persons as payment for the acquisition of specified assets. While the corporation was authorized by its Articles of Incorporation to issue preferred shares generally, the shares issued to the appellants were structured to meet the requirements of the appellants as vendors of the controlling interest in the operating companies that Central Capital was acquiring. In my view, these preference shares are the equivalent of vendor shares in that the appellants received them in exchange for the transfer of assets to Central Capital.

44 In the case of McCutcheon, the retraction provision in the preferred shares represented only partial payment of an agreed value for the assets, but in the case of SYH, they represented the full value. In both cases, the agreed value as reflected in the retraction price was guaranteed by Central Capital to be retractable at a fixed price at a predetermined date. By postponing the obligation to pay the purchase price in this way, Central Capital was using the retraction provisions of the preference shares as a vehicle for the financing of its expanding asset base. The appellants, for their part, deferred the realization of the purchase price of their assets to the agreed dates and thereby extended credit to the corporation. In return for extending credit for some or all of the selling price, the appellants agreed to receive dividends calculated in advance but payable as and when declared by the board of directors.

45 Thus, in looking at the substance of the transaction that led to the issuance of the preference shares, it appears to me that the retraction clauses were promises by Central Capital to pay fixed amounts on definite dates to the appellants. They evidenced a debt to the appellants. The fact that the appellants as holders of the preference shares had rights as shareholders in the corporation up to the time when the retraction clauses were exercisable did not affect their right to enforce payment of the retraction price when it became due.

46 The validity of an analysis directed to the substance of the transaction is supported by *Canada Deposit Insurance Corp. v. Canadian Commercial Bank*, [1992] 3 S.C.R. 558, a judgment of the Supreme Court of Canada delivered by Iacobucci J. The case involved a number of corporations constituting a support group which entered into an arrangement to provide emergency financial assistance to Canadian Commercial Bank ("CCB"). On the ultimate failure of the bank, the issue arose as to whether the monies advanced to CCB under this support arrangement were in the nature of a loan or in the nature of a capital investment. I find instructive to our situation Iacobucci J.'s observation at pp. 590-1:

> As I see it, the fact that the transaction contains both debt and equity features does not, in itself, pose an insurmountable obstacle to characterizing the advance of $255 million. Instead of trying to pigeonhole the entire agreement between the Participants and CCB in one of two categories, I see nothing wrong in recognizing the arrangement for what it is, namely, one of a hybrid nature, combining elements of both debt and equity but which, in substance, reflects a debtor-creditor relationship. Financial and capital markets have been most creative in the variety of investments and securities that have been fashioned to meet the needs and interests of those who participate in those markets. It is not because an agreement has certain equity features that a court must either ignore these features as if they did not exist or characterize the transaction on the whole as an investment. There is an alternative. It is permissible, and often required, or desirable, for debt and equity to co-exist in a given financial transaction without altering the substance of the agreement. Furthermore, it does not follow that each and every aspect of such an agreement must be given the exact same weight when addressing a characterization issue. Again, it is not because there are equity features that it is necessarily an investment in capital. This is particularly true when, as here, the equity features are nothing more than supplemen tary to and not definitive of the essence of the transaction. When a court is searching for the *substance* of a particular transaction, it should not too easily be distracted by aspects which are, in reality, only incidental or secondary in nature to the main thrust of the agreement. [Emphasis in original.]

47 I have no difficulty in finding that the appellants' preferred shares with their retraction clauses are of "a hybrid nature, combining elements of both debt and equity". As to the equity component, the appellants are shareholders prior to exercising their retraction rights in that they have the right to vote in certain circumstances and have a right to receive dividends when and if they are declared by the board of directors. The debt component is more significant however. The shares were not issued to investors, but to vendors of property. The vendors were entitled to receive a fixed sum at a specified time in payment therefor. Pending payment, the vendors were entitled to receive dividends which were the equivalent of interest on the unpaid balance.

48 I can think of no reason why the holders of these preferred shares should not be treated as both shareholders and creditors. It does not concern me that these appellants act as shareholders before their retraction rights are exercisable. Nor do I see any hardship to other creditors of Central Capital arising from the ability of these appellants to claim as

creditors in the restructuring of the company given that the appellants are unpaid with respect to substantial assets sold to the corporation and now transferred on the restructuring to GIGL.

49 Much was made in argument of the fact that the retraction amounts could not be paid on the retraction dates. In the case of McCutcheon, the corporation was insolvent and subject to court administration on the due date of July 1, 1992. In the case of SYH, the retraction date did not arrive before the reorganization was complete.

50 The narrow issue of the effect of insolvency on a debt has been dealt with by the British Columbia Court of Appeal in *Re East Chilliwack Agricultural Co-op.* (1989), 74 C.B.R. (N.S.) 1. In this case, the appellants were one-time members of three co-operative associations. The rules of the co-operatives permitted a member to withdraw upon written notice to the board of directors to that effect. The member was entitled to elect to have his shares redeemed either in equal instalments over five years or in one payment with interest at the end of five years. In April of 1987, the superintendent of co-operatives, under the authority of the *Cooperative Association Act*, R.S.B.C. 1979, c. 66, suspended the co-operatives' right to redeem their shares until their financial situation was no longer impaired. The three co-operatives subsequently went bankrupt and a two-fold issue came before the bankruptcy court: (1) whether those members whose notices of withdrawal had been accepted by the board of directors but who had not yet received the value of the shares were entitled to rank as unsecured creditors, and (2) whether those who had delivered notices that had not been accepted were to be treated as unsecured creditors. The court of first instance found that the members were shareholders and answered both questions in the negative. That judge was reversed on appeal with the majority of the court deciding that the answer to both questions was yes. Hutcheon J.A. for the majority stated at p. 13:

> I shall use Mr. Neels [a co-operative member] as my example. According to R. 3.06 he ceased to be a shareholder in May 1983. In May 1984 the Agricultural Co-operative owed him the first of five payments, or $686.40. I know of no principle of law that would support the proposition that Neels could not sue for that amount if the Agricultural Co-operative failed to pay in May 1984. Of course, the superintendent of co-operatives has power under s. 15(2) to suspend payments if, in his opinion, the financial position of the co-operative was impaired. Subject to that power, the position of Neels and the Agricultural Co-operative would be that of ordinary creditor and debtor. In my opinion, the order made by the judge cannot be sustained on the first ground.

From this case, I extract the proposition that the fact of an insolvency, whether declared or not, does not change the nature of the relationship between debtor and creditor. It continues notwithstanding the inability of the debtor to pay or the creditor to collect.

51 It appears to me, with deference, that the issue of the effect of Central Capital's insolvency on the character of the retraction payments is something of a red herring. The contest in this appeal is between those who are conceded to be unsecured creditors and those whose claim to such status is contested. In both cases, any right to payment was suspended by Central Capital's announcement in December of 1991 that it was insolvent and that it had suspended all payments of principal and interest to unsecured creditors. This course of action was not freely chosen but was required by law. Any payments to creditors after the date of insolvency would be voidable at the instance of creditors on the basis that they were fraudulent preferences. In addition to ss. 95 and 96 of the *Bankruptcy Act* dealing with fraudulent preferences generally, there is provincial legislation in the form of the *Fraudulent Conveyances Act*, R.S.O. 1990, c. F.29, and the *Assignments and Preferences Act*, R.S.O. 1990, c. A.33, that would be applicable. Counsel for the unsecured creditors maintains that the right to redeem shares, including preference shares was postponed by s. 36(2) of the *CBCA, supra*. I am not certain that s. 36(2) applies to the retraction provisions of the appellants' preference shares as opposed to the redemption privileges of Central Capital, but in my opinion the point is irrelevant to this appeal. Once Central Capital acknowledged its insolvency, it could neither redeem its shares nor honour its retraction obligations. The whole purpose for the creditors applying to the court for a stay of Central Capital's obligations, including those of the acknowledged unsecured creditors, was to arrange for a scheme of payments to all creditors that could not be subject to attack as preferences. There is no suggestion on the evidence before us that the claims of unsecured creditors accepted by the Administrator were claims that had crystallized prior to the insolvency of Central Capital. Nor is it suggested that any creditors were rejected because some or all of their claims were not payable until after the date of the insolvency. The

fact of insolvency, by itself, does not provide a rational basis for distinguishing the claims of the appellants from those of other unsecured creditors.

52 Much also was made of the provision in the Articles authorizing the shares in question, which states that if the obligation to redeem "would be contrary to applicable law", then Central Capital "shall redeem only the maximum number of [shares] it is then permitted to redeem". Counsel for the unsecured creditors submits that the reference to "applicable law" is to s. 36 of the *CBCA*. The reference certainly embraces the *CBCA*, but it is not restricted by its terms to that statute. For example, "applicable law" would also capture s. 101 of the *Bankruptcy Act*, which provides for penalties against directors and shareholders where insolvent companies redeem shares or pay dividends.

53 There was no evidence led as to why this provision was placed in the Articles and the share certificates. It appears to be a standard clause in all the preference shares issued by the corporation and not just those that were adapted to the appellants' situations where specific retraction clauses were drafted to satisfy the particular asset acquisitions. For my part, I have difficulty in understanding how a consideration of this provision assists the process of determining the underlying character of the retraction obligations. The statement is so self-evident that it is almost banal. I can only assume that the statement was included in the share provisions of a corporation marketing its securities world-wide so as to inform purchasers that legal restrictions in this jurisdiction apply to the company's right to redeem shares.

54 In summary then regarding the insolvency argument, these various statutes prohibit payments of any kind to shareholders by an insolvent company. As I understand it, counsel does not question that when a dividend has been lawfully declared by a corporation, it is a debt of the corporation and each shareholder is entitled to sue the corporation for his proportion: see *Fraser and Stewart, supra*, at p. 220 for a list of authorities. However, once a company is insolvent it cannot make payments to shareholders or creditors so long as it continues to be insolvent. On the other hand, nowhere in the *CBCA* or else where will we find authority for the proposition that once a corporation is insolvent, it is no longer obliged to pay its debts. The obligation is postponed until the insolvency is corrected or the corporation makes an accommodation with its creditors and obtains a release with or without the assistance of the various statutes dealing with insolvency.

55 The existence of provisions prohibiting payment to shareholders and creditors on insolvency does not in anyway assist the determination of whether the retraction obligations at issue in this appeal constitute a debt or a return of capital at the time they are payable. Speaking of the obligation to honour the retraction in terms of the corporation redeeming its shares also introduces the wrong emphasis. The corporation is not redeeming the shares at its option as contemplated by most redemptions. It is being forced to redeem them because of a prior contractual obligation for which the preferred shareholder gave good consideration. It is for this reason that I question whether s. 36 of the *CBCA* is the appropriate reference point. This is not the type of payment which concerned Jessel M.R. in *Flitcroft's Case, supra*.

56 At the risk of over simplifying this case, it appears to me that many of the arguments made against the appellants' claims to be creditors of Central Capital are impermissible in the context of the Agreed Statement of Facts. The issue in appeal is frozen in time by the stipulation that the court is to determine if these retraction clauses created a debt within the meaning of the *Bankruptcy Act* on June 15, 1992. The arguments against the appellants' claims also ignore that debts under s. 121(1) of the *Bankruptcy Act* need not be payable at the date of the bankruptcy (or June 15, 1992 in our scenario). They need only come beneath the broad umbrella of "debts and liabilities, present and future, to which [Central Capital] is subject" on June 15, 1992. The fact that the debts could not be paid after June 15, 1992, does not mean that they were not provable claims pursuant to s. 121 of the *Bankruptcy Act*. Moreover, assuming the retraction clauses created a debt payable on a future date, neither the order of Houlden J. nor the restrictions in the Articles creating the shares themselves purported to extinguish that debt.

57 There is nothing in either the Articles of Central Capital or in the law that excuses the obligation to pay the retraction amounts. Rather, discharge of the obligation is simply postponed until the cessation of the disabling event of insolvency. Article 4.3 of the Senior Series B Provisions provides the mechanism for future redemption of tendered

shares that are not redeemed because such redemption would be contrary to law. Article 4.5 provides that the inability to effect a redemption does not affect the obligation to pay dividends accrued or accruing on the unredeemed shares.

58 So far as SYH is concerned, the retraction price was not payable until the fifth anniversary of the June 1989 sale of assets. Therefore, no issue of the effect of insolvency arose in 1992. The orders of Houlden J. of June 15 and July 9, 1992 changed the rules of the game. If this appellant is a creditor, it does not have to wait until the retraction date. It can claim as a creditor now. It did and the claim was disallowed. However, if this court holds that the claim should have been allowed, then in accordance with the narrow issue put to us, SYH is entitled to be accepted as a full creditor in the entire reorganization of Central Capital.

59 An additional factor raised by counsel during argument was that Article 7, *supra*, provides that in the event of the liquidation, dissolution or winding-up of Central Capital, whether voluntary or involuntary, or any other distribution of assets among its shareholders for the purpose of winding up its affairs, the holders of these preferred shares are entitled to recover "from the assets of Central Capital" the retraction price plus all accrued and unpaid dividends thereon. Such amount is to be paid prior to payment to junior ranking shareholders. The Article further provides that "[u]pon payment of such amounts, the holders of [the preferred shares] shall not be entitled to share in any further distribution of assets of [Central Capital]". Because it is trite law that shareholders are entitled to recover from assets only after all ordinary creditors have been paid in full, counsel for the unsecured creditors submits that the fact that the clause contemplates priorities between shareholders on a winding up or a liquidation of assets is clear evidence that they were shareholders only.

60 I have two responses to this submission. The first is the obvious, that we are not dealing with this contemplated event. We are dealing with a reorganization in which the parties have put a single question to the court: are the appellants creditors? Consideration of issues of priority or the valuation of claims have been taken away by the narrow scope of the agreed question. If the answer to the question posed is yes, then in accordance with the Agreed Statement of Facts, the appellants are entitled to have their claims as creditors allowed under the Subscription and Escrow Agreement and to participate in the Amended Plan of Arrangement as Senior Creditors. If the answer is no, they are to be treated as the Administrator has treated them: they are not creditors at all and are restricted to receiving Central New Common Shares under the Amended Plan of Arrangement.

61 My second response is that counsel for the unsecured creditors misses the significance of the clause. He assumes that there will be a deficiency in all circumstances leading up to a liquidation, dissolution or winding up that will necessitate a *pro rata* distribution, first to creditors and then to shareholders of all classes. However, the clause does not say that those with retraction rights are not creditors. It says that the retraction amounts are to be paid out of assets, not suplus. Once the retraction amounts have been paid in full, the appellants are not entitled to share in any further distribution. This contemplates a surplus after all creditors, including the appellants, have been paid in full. Accordingly, far from classifying the appellants as shareholders, the clause provides that they are not entitled to be treated as shareholders under a winding up or liquidation but only as creditors.

62 Finally, with respect to SYH's claims, it was submitted that these claims were so contingent as to be virtually non-existent. The claims anticipate a retraction date that as of June 15, 1992 was some two years into the future. Upon approval of the Amended Plan of Arrangement of December 18, 1992, the shares of SYH were cancelled and replaced by a new issue of shares, the Central New Common Shares. Counsel relied upon the finding of Feldman J. that there was then no discernable basis upon which the retraction could occur. Once again, with respect, this conclusion misses the point. Following the final order of Houlden J. approving the Amended Plan of Arrangement, all the shares *and* all the debts of Central Capital disappeared. There was thereafter no discernable basis upon which any event contemplated by any debt or share instruments could occur. We are only concerned with the status of shareholders and creditors as of June 15, 1992.

63 Based on the reasons set out above, I have concluded that the retraction amounts do fall within the definition of debts and liabilities, present or future, to which Central Capital was subject on June 15, 1992. This does not apply to

undeclared dividends however, because until a dividend is declared no action on behalf of a shareholder lies to enforce its payment: see *Fairhall v. Butler*, [1928] S.C.R. 369 at 374. If undeclared dividends have been claimed by any of the appellants they should be disallowed. In all other respects the claims should be allowed.

64 Accordingly, I would allow the appeals, set aside the order of Feldman J. and order that the appellants have provable claims that are to be allowed by the Administrator. The record does not disclose what order if any Feldman J. made as to costs. Certainly the appellants are entitled to their costs of this appeal. If the parties are unable to agree with respect to any other disposition of costs, I would suggest that they submit their positions to the court in writing.

***Weiler J.A.*:**

65 I have had the benefit of reading the reasons of Finlayson J.A. and for the reasons which follow I respectfully disagree with his conclusion that the appellants are entitled to prove a claim pursuant to the *Companies' Creditors Arrangement Act*, R.S.C. 1985, c. C-36 (the "*CCAA*").

66 Section 12(1) of the *CCAA* requires that persons wishing to participate in a reorganization have claims which would be provable in bankruptcy. Section 121(1) of the *Bankruptcy and Insolvency Act*, R.S.C. 1985, c. B-3, states that "[a]ll debts and liabilities, present or future ... shall be deemed to be claims provable in proceedings under this Act."

67 In order to decide whether the obligation of Central Capital to redeem the preferred shares of the appellants is a claim provable in bankruptcy, it is necessary to characterize the true nature of the transaction. The court must look to the surrounding circumstances to determine whether the true nature of the relationship is that of a shareholder who has equity in the company or whether it is that of a creditor owed a debt or liability by the company: *Canada Deposit Insurance Corp. v. Canadian Commercial Bank*, [1992] 3 S.C.R. 558. In this case, the decision is not an easy one. Where, as here the agreements between the parties are reflected in the articles of the corporation, it is necessary to examine them carefully to characterize the true relationship. It is not disputed that if the true nature of the relationship is that of a shareholder-equity relationship after the retraction date and at the time of the reorganization, then the appellants do not have a claim provable in bankruptcy. Consequently, they will not have a claim under the *CCAA*.

68 As I see it, three main questions need to be addressed:

(1) Was Feldman J. correct in characterizing the relationship between Central Capital and the companies owned by James McCutcheon ("McCutcheon"), and between Central Capital and Scottish and York Holdings Limited (the predecessor of S.Y.H., hereinafter referred to as "SYH"), as a shareholder relationship?

(2) Did the nature of the relationship change after the retraction date for redeeming the shares of McCutcheon or, in the case of SYH, at the time of the reorganization?

(3) If the nature of the relationship is not a shareholder-equity relationship, are the appellants entitled to prove a claim under the *CCAA*.?

69 In addition, the appellants raise the question of whether they have a right to prove a claim for dividends, which have accrued but have not yet been declared payable. The price to be paid by Central Capital to McCutcheon on the retraction date, July 1, 1992, was $25 per share plus *all accrued and unpaid dividends thereon*. The dividends are therefore part of the retraction price. Similar provisions apply to SYH.

70 The reasons of Finlayson J.A. contain a comprehensive statement of the background to the litigation and I will therefore only refer to the facts in a summary fashion.

71 James McCutcheon and his brother sold their shares in Central Guarantee Trust Company to Central Capital Corporation ("Central Capital"), a trust company, for $575 a share. They received $400 per share in cash. The balance of $175 owing on each share was paid through the issue of seven preferred shares in Central Capital, with each share having a par value of $25. Following this transaction, McCutcheon purchased his brother's shares. These preferred shares, known

as Senior Series B Preferred Shares, were to be listed on the Toronto Stock Exchange. These shares carried with them a retraction privilege. The shareholder had the right to have his shares redeemed by Central Capital on July 1, 1992, for $25 a share, provided that such redemption would not be "contrary to law in the context of the Corporation's current financial position." McCutcheon chose not to sell his shares.

72 Scottish & York Holdings Limited (the predecessor to SYH) sold its shares in certain insurance companies which it owned to Central Capital. Central Capital paid for these shares by the issue of Series A Junior Preferred Shares. These shares were not listed on a stock exchange. SYH had the right to have its shares redeemed by Central Capital on or after September 1994 at a price of $1 per share, subject to the provisions of the *Canada Business Corporations Act*, R.S.C. 1985, c. C-44 (the "*CBCA*").

73 It should be noted that the right of retraction was not unique to these two classes of shareholders. Even common shareholders had the right to have their shares retracted under certain circumstances.

74 By December 1991, Central Capital was unable to pay its liabilities as they became due and its total liabilities greatly exceeded the value of its assets. As a result, the various banks and subordinated debtholders, collectively referred to as the lenders, had a choice to make. Inasmuch as the definition of a corporation in s. 2 of the *Bankruptcy and Insolvency Act* precludes a creditor from bringing a petition against a trust company, they could either wind up Central Capital under the *Winding-up Act*, R.S.C. 1985, c. W-11, or they could try to restructure Central Capital under the *CCAA*. In a winding up or liquidation, the trustee would sell the company's assets, either piecemeal or as a going concern, to third parties. The proceeds from the sale would then be distributed to those who proved a claim according to set priority rules. In a reorganization, existing fixed amounts owed to Central Capital's creditors would be traded for new claims and ownership interests in the reorganized corporation which would remain a going concern. The lenders chose to reorganize.

75 Two transactions were involved. In the Consolidated Insurance Group Limited transaction, or "CIGL transaction", Central Capital transferred some of its significant assets to a newly incorporated company, CIGL. Thirty-nine creditors of Central Capital then elected to exchange a portion of Central Capital's debt owing to them for equity in this newly incorporated company. In the second transaction, common shares were issued for the remaining assets of Central Capital. The creditors of Central Capital were given 90 per cent of the common shares of the reorganized company. The balance of 10 per cent was allocated to the shareholders of Central Capital. All of the preferred, common and subordinate voting shares in Central Capital were then converted into these "new" common shares. The reorganization was subsequently approved by the creditors and sanctioned by the Court as required by the Act, but this approval was given without prejudice to any claims that McCutcheon and SYH might have.

76 McCutcheon's position was that the right to have his shares retracted accrued before the reorganization, and that his exercise of this right of retraction in May 1992 constituted a present debt or liability entitling him to rank as a creditor in the CIGL transaction and in the reorganized Central Capital. SYH's position was that the right to have its shares retracted in 1994 created a future debt or liability and thus a provable claim. The administrator of Central Capital disallowed both claims. McCutcheon and SYH appealed the administrator's decision to Feldman J. In dismissing their appeals, she held that the appellants were shareholders and that the right of retraction attaching to the shares did not change the nature of the shares from equity into debt.

1. Was Feldman J. correct in characterizing the agreement between Central Capital and the companies owned by McCutcheon, and between Central Capital and SYH, as creating a shareholder relationship between the parties?

77 Feldman J. analyzed the transaction and came to the conclusion that it was an equity transaction.

78 Finlayson J.A. is of the opinion that the nature of this transaction is different and that Feldman J. erred in not showing sensitivity to the fact that she was dealing with the sale of a business by its owners. He is of the opinion that the shares issued by Central Capital are the equivalent to "vendor shares" in that the appellants received them in exchange for the transfer of assets to Central Capital. He does not see the transaction as being either a contribution to capital by

McCutcheon and SYH or as a return of capital. Although the transaction has debt and equity features, Finlayson J.A. is of the opinion that the true nature of the transaction is that of a debt owing by Central Capital to McCutcheon and SYH for the shares in their companies.

79 My analysis of the transaction is that when McCutcheon sold his shares in Central Guaranty and took back preferred shares in Central Capital as part payment, he transferred part of his capital investment from a smaller entity to a larger entity. Similarly, SYH transferred its investment in the shares of the insurance companies for shares in the larger entity of Central Capital. Both appellants could look to a larger asset base than before to generate a return on their capital. Until the retraction date, McCutcheon chose to take the risk of continuing his investment in Central Capital, which offered the prospect of a stable, yet relatively high, annual return through the receipt of 7-5/8 per cent dividends. Because the shares traded on the Toronto Stock Exchange, he would have had the option of realizing upon his investment by selling his shares for what they would bring on the open market, but he did not do so. In the case of SYH, although these shares were not required to be publicly listed, the corporation's articles did not restrict their transfer. The corporation's articles indicate that these shares had some preference over other shares with respect to the right to receive dividends and in the distribution of assets after creditors are paid on a liquidation. As preferred shareholders, McCutcheon and SYH did not have a voice in company affairs unless the company failed to pay the dividends it had promised to pay. This is quite typical: see Welling, *Corporate Law in Canada*, 2nd ed. (1991) at p. 604; Ziegel et al, *Cases and Materials on Partnership and Canadian Business Corporations*, 2nd ed. (1989) at p. 1198. Risk taking, profit sharing, transferability of investment, and the right to participate in a share of the assets on a liquidation after the creditors have been paid are the hallmarks of a shareholder: see R.M. Bryden, "The Law of Dividends" contained in Ziegel ed., *Studies in Canadian Company Law* (1967) at p. 270. In my opinion, Feldman J. was correct that the true nature of the relationship between the parties initially was that of an equity transaction.

2. Did the nature of the relationship change after the retraction date for McCutcheon's shares and did the reorganization trigger a right of redemption respecting SYH's shares?

80 Ordinarily, shareholders cannot realize on their investment in a company except by transferring their shares. The retraction privilege attaching to the shares gives the preferred shareholders the option of realizing on their investment other than by transferring their shares to a third party.

81 Feldman J. found that McCutcheon continued to be a shareholder after the retraction date and that he remained a shareholder at the time of the reorganization. She found SYH's claim to be too remote inasmuch as the retraction date not yet arrived at the time of the reorganization.

82 The appellants argue that Feldman J. erred in this conclusion. They submit that although McCutcheon and SYH may have been shareholders initially, this relationship changed. Upon McCutcheon's exercise of his right to have the corporation pay him the retraction price of his shares, he ceased to be a shareholder. When Central Capital failed to pay him, he became a creditor of the corporation. In the case of SYH, it is submitted that when the lenders opted to reorganize the company, they, in effect, triggered the obligation to redeem SYH's shares.

(a) Nature of the transaction's relationship to the capital structure of the corporation

83 Section 25(3) of the *CBCA* states that shares shall not be issued until the consideration for the shares is fully paid either in cash or with property having a fair market value equivalent to the shares issued. Therefore, by issuing preferred shares with a fixed par value, Central Capital paid McCutcheon for his shares of Central Guaranty and paid SYH for the shares of the insurance companies that Central Capital received. Central Capital could not issue preferred shares *except* as full payment for the shares it received. The preferred shares were part of the capital of Central Capital and the preferred shares were always shown as shareholders' equity on Central Capital's books. The capital of the corporation is representative of the assets available to pay creditors. If, on the date for redemption of McCutcheon's shares, or on the date of reorganization in the case of SYH, the shares are redeemed, the amount paid must be deducted from the stated capital of the corporation s. 39 *CBCA*. Consequently, the total assets that Central Capital will have available to

pay the lenders and other creditors outside the corporation will be reduced. A reduction of capital by the redemption of redeemable shares is permitted under the *CBCA* but only where the requirements of s. 36 are met.

(b) Section 36 of the CBCA

84 Section 36 of the *CBCA* makes the ability of a corporation to redeem its redeemable shares subject to (1) its articles and (2) a solvency requirement. For ease of reference s. 36 is reproduced below.

> *36.*(1) Notwithstanding subsection 34(2) or 35(3) [both of which deal with a corporation's acquisition of its own shares in other circumstances], but *subject to subsection (2) and to its articles*, a corporation may purchase or redeem any redeemable shares issued by it at prices not exceeding the redemption price thereof stated in the articles or calculated according to a formula stated in the articles.
>
> (2) A corporation shall not make any payment to purchase or redeem any redeemable shares issued by it if there are reasonable grounds for believing that
>
> (*a*) the corporation is, or would after the payment be, unable to pay its liabilities as they become due; or
>
> (*b*) the realizable value of the corporation's assets would after the payment be less than the aggregate of
>
> (i) its liabilities, and
>
> (ii) the amount that would be required to pay the holders of shares that have a right to be paid, on a redemption or in a liquidation, rateably with or prior to the holders of shares to be purchased or redeemed. [Emphasis added.]

85 There is no dispute that Central Capital was unable to redeem McCutcheon's shares on the retraction date. Nor could it redeem SYH's shares on the date of the reorganization. The appellants agree that the effect of s. 36 renders the agreement between themselves and Central Capital unenforceable. It is the position of the appellants, however, that s. 36 does not extinguish a debt or liability which they say has been created. The appellants rely on the decision in *Re East Chilliwack Agricultural Co-op.* (1989), 74 C.B.R. (N.S.) 1 (B.C. C.A.) in support of their position that a debt or liability is created notwithstanding the solvency requirements of s. 36 respecting payment. The appellants' submission does not take into consideration the major differences between the decision in *East Chilliwack* and the present situation relating to the timing, effect of the solvency requirements and the provisions in the articles governing the relationship of the parties.

> 1) In *East Chilliwack*, farmers who owned shares in an agricultural co-operative gave notice to the co-op of their intention to have their shares redeemed. After the notices had been given, the superintendent of co-operatives suspended the right of the co-op to redeem its shares. Here, the request to redeem the shares by McCutcheon and the retraction date occurred after Central Capital had sent out a notice that it would not be able to redeem the shares due to its financial position. SYH had no right to demand that its shares be retracted until the retraction date, which was some two years after the date of Central Capital's insolvency.
>
> As in the instant case, the issue in *East Chilliwack* was whether the farmers were entitled to rank with the creditors of the co-op. Hutcheon J.A., with Toy J.A. concurring, held that they were entitled to be treated as creditors.
>
> At the outset of his reasons, Hutcheon J.A. noted, at p. 11, that the effect of the superintendent's suspension on the farmers' rights was not argued on appeal and that the court had been asked to determine the status of the farmers without regard to the suspension.
>
> Here, the effect of Central Capital's inability to redeem its shares due to insolvency is very much in issue and cannot be ignored. Although the articles provide for the redemption of all of the shares held by McCutcheon and SYH on or after the retraction date, the articles also state that Central Capital will only redeem so many of its shares as would not be "contrary to law." Pursuant to s. 36(1) of the *CBCA*, a corporation may purchase or redeem redeemable shares, but the corporation is prohibited from doing so if the corporation is unable to pay its liabilities as they

become due or if the assets of the corporation are less than the total of its liabilities and the amount required for the redemption. Because Central Capital could not comply with the solvency requirements, redemption would be "contrary to law."

2) In *East Chilliwack, supra*, at p. 13, the rules of the co-op provided that upon the giving of a notice of redemption, the farmer giving it ceased to be a shareholder. Central Capital's articles do not state that a request for redemption of the holder's shares terminates his status as a shareholder. McCutcheon continued to have the right to receive dividends pursuant to Article 4.5 while his shares were not redeemed. In effect, so long as Central Capital was unable to redeem the shares but had profits, McCutcheon continued to be entitled to a share of the profits through the declaration of dividends. If the dividends remained unpaid for eight consecutive quarters then, pursuant to Article 8, McCutcheon had the right to receive notice of, and to attend, each meeting of shareholders at which directors were to be elected and was entitled to vote for the election of two directors. The articles relating to the preferred shares held by SYH contain a similar provision. The result of insolvency as envisaged by the articles was that McCutcheon and SYH would continue as shareholders.

3) In *East Chilliwack, supra*, Hutcheon J.A. held, at p. 13, that, subject to the power of the superintendent of co-operatives, the farmer's position would be that of an ordinary creditor.

Here, the terms attaching to McCutcheon's shares do not give him that right. Instead, he is given the right to continue to receive dividends so long as the company cannot pay him. The articles relating to the shares held by SYH contain a similar provision. In addition, Article 4.3(b), respecting the retraction of the shares, indicates that if the directors have acted in good faith in making a determination that the number of shares the corporation is permitted to redeem is zero, then the *corporation* is not liable in the event this determination proves inaccurate. This would hardly be the position *vis à vis* an ordinary creditor.

4) Article 8 and a similar provision in the articles relating to the shares held by SYH provide that upon a sale of all or a substantial part of the company's undertaking, the preferred shareholders have a right to receive notice of and to be present at the meeting called to consider this sale. The farmers in *East Chilliwack* do not appear to have had any similar right.

5) Article 7 provides that in the event of a liquidation, dissolution or winding-up of the Corporation the preferred shareholders have a right to receive $25 per Series B Senior Preferred Share before the corporation pays any money or distributes assets to shareholders in any class subordinate or junior to the Series B Senior Preferred Shares. Similarly, SYH, as the holder of Series A and B Junior Preferred shares has the right, upon the dissolution or winding up of the corporation, to receive a sum equivalent to the redemption amount for each series junior preferred share. This right is subject to the rights of shares ranking in priority to the shares of these series, but is ahead of the rights of the holders of common shares.

Nothing in the articles concerning the retraction date affects the right of McCutcheon and SYH to participate in Central Capital's liquidation. The participation of the farmer in *East Chilliwack* ceased once he had given notice to redeem. Article 4.4 of Central Capital provides that once the shares have been tendered for retraction this election is irrevocable on the part of the holder. In the event that payment of the retraction price was not made, however, the holder had the right to have all deposited share certificates returned. Central Capital offered to return McCutcheon's shares to him, but he refused. Because McCutcheon retained all the rights and privileges of a preferred shareholder after the retraction date, the fact that he refused to take back his share certificates cannot alter the true nature of the relationship. The refusal was merely evidence of a dispute concerning what the relationship was. SYH also retained its full status as a shareholder until the date of the reorganization. This was not the situation in *East Chilliwack*.

86 By way of summary, on the date of the reorganization McCutcheon and SYH had not ceased to be preferred shareholders of Central Capital. The rights attaching to their retractable preferred shares entitled them to continue to share in the profits of the company when these were declared as dividends, to vote at shareholders meetings to elect

directors so long as dividends remained unpaid for a specified period of time, and, on a winding up of the company, to participate in the distribution of assets that remained after the creditors were paid according to the ranking of the series of their shares. The company's obligation to redeem its shares was not absolute. Instead, the articles provided for what was realistically a "best efforts" buy-back based on solvency and continuation as a shareholder to the extent a buy-back could not take place. In *East Chilliwack*, because the farmer ceased to be a shareholder, the articles do not appear to make any provision for continued participation or for the postponement of payment depending on the solvency of the co-op.

(c) Evidence of a debtor-creditor relationship is lacking in the articles

87 Looked at another way, after the retraction date and at the time of the reorganization, the common features of a debtor-creditor relationship are not in evidence in Central Capital's articles. The agreements between the parties contain no express provisions that the redemption of the shares is in repayment of a loan. The corporation was not obliged to create any fund or debt instrument to ensure that it could redeem the shares on the retraction date. There is no indemnity in the event that the money is not repaid on the retraction date. There is no provision for the payment of any interest after the retraction date in the event that the money is not repaid on the retraction date. There is no provision that after the retraction date and in the event of insolvency, the appellants would have the right to have the company wound up. (See *Imperial General Properties Ltd. v. R.*, *(*sub nom. *R. v. Imperial General Properties Ltd.)* [1985] 2 S.C.R. 288, for a case where the articles of the company contained this right.) There is no provision that upon a winding up or insolvency the parties are entitled to rank *pari passu* with the creditors as was the case in *Canada Deposit Insurance Corp. v. Canadian Commercial Bank, supra*.

(d) The effect of the reorganization

88 Finlayson J.A. is of the view that it is immaterial that the articles provide, in the event of the liquidation, dissolution or winding-up of the company, that the appellants are only entitled to rank after the creditors but ahead of the junior ranking shareholders. In his view, this provision is irrelevant because we are not dealing with a liquidation but with a reorganization. He finds it significant that, like debtors, the preferred shareholders are not entitled to participate in any surplus once they have been paid. I am of the view that this provision in the articles is significant. It represents a clear indication that the holders of the retractable shares were not to be dealt with on the same footing as ordinary creditors even after the retraction date. Instead, they were to be dealt with as shareholders, albeit an elevated class. Under the *CBCA* all shares carry equal rights. Words used in the articles to differentiate a class of shares are nothing more than authorized deviations from this statutory position of equality: Welling, *supra*, at p. 683.

89 The appellants submit that a winding-up or liquidation is not the same as a reorganization. This is true. Both, however, are methods of dealing with insolvency. Both are methods for secured creditors to enforce their claims by seizing the assets in which they hold security interests. If the value of the corporation as a going concern exceeds the liquidation value of the assets, it is in the interest of all the debt holders that the corporation be preserved as a going concern. The purpose of both a liquidation and a reorganization is to permit the rehabilitation of the insolvent person unfettered by debt: *Vachon v. Canada (Employment & Immigration Commission)*, [1985] 2 S.C.R. 417. By virtue of s. 20 of the *CCAA*, arrangements under the Act mesh with the reorganization provisions of the *CBCA* so as to affect the company's relations with its shareholders. Shareholders have no right to dissent to a reorganization: s. 191(7), *CBCA*. On a reorganization, among other things, the articles may be amended to alter or remove rights and privileges attaching to a class of shares and to create new classes of shares: s. 173, *CBCA*. These statutory provisions provide a clear indication that, on a reorganization, the interests of all shareholders, including shareholders with a right of redemption, are subordinated to the interests of the creditors. Where the debts exceed the assets of the company, a sound commercial result militates in favour of resolving this problem in a manner that allows creditors to obtain repayment of their debt in the manner which is most advantageous to them.

90 The similarities between a liquidation and a reorganization, together with the express statement in the articles of Central Capital with respect to what is to happen on a winding-up, dictate that the interests of the holders of retractable shares, McCutcheon and SYH, are subordinated to the creditors and they are not entitled to claim under the *CCAA*

equally with the creditors. This position is also consistent with the provisions of the *Bankruptcy and Insolvency Act* and the *Winding-up Act*. In the case of an insolvency where the debts to creditors clearly exceed the assets of the company, the policy of federal insolvency legislation appears to be clear that shareholders do not have the right to look to the assets of the corporation until the creditors have been paid.

Dividends

91 Although dividends were payable on the shares of McCutcheon and SYH, no dividends were in fact declared. The appellants contend that the dividends, which have accrued but which were not declared, are a debt or liability because they were stipulated to be part of the retraction price.

92 Article 7 of Central Capital respecting McCutcheon's shares states that in the event of liquidation, dissolution or winding up of the corporation, the shareholders are entitled to receive not only the $25 per Series B preferred share, but "all accrued and unpaid dividends thereon, whether or not declared ... before any amount is paid by the Corporation or any assets of the Corporation are distributed to the holders of any shares ... ranking as to capital junior to the Series B Senior preferred Shares."

93 It is trite law that a dividend may only be declared if a company is solvent. For corporations governed by the *CBCA*, it appears that the common law tests for solvency have all been subsumed or overruled: *McClurg v. Minister of National Revenue*, *(*sub nom. *R. v. McClurg)* [1991] 2 W.W.R. 244 (S.C.C.) at 259, 260.

94 Section 42 of the *CBCA* provides:

> A corporation shall not declare or pay a dividend if there are reasonable grounds for believing that
>
> (*a*) the corporation is, or would after the payment be, unable to pay its liabilities as they become due; or
>
> (*b*) the realizable value of the corporation's assets would thereby be less than the aggregate of its liabilities and stated capital of all classes.

95 Section 42 prevents the corporation from declaring or paying a dividend when it does not meet certain solvency requirements. There was no declaration of a dividend in the present case. Any obligation to pay a dividend as part of the retraction price cannot therefore be enforced when the company is insolvent. Dividends which have accrued but which are unpaid are not considered to be a debt because, on reading the articles as a whole, the provision for payment is not one which is made independant of the ability to pay: see Welling, *supra*, at p. 689, citing *Porto Rico Power Co., Re*, [1946] S.C.R. 178 (S.C.C.), where it was held there was no guarantee of payment and hence the accrued but unpaid dividends were not a debt. Instead, accrued but unpaid dividends are considered to be akin to a return of capital. Making these accrued dividends part of the retraction price does not alter this.

96 By way of analogy to the treatment of dividends, it could be said that until the company has declared it will redeem the shares which are tendered to it the obligation to redeem them is not a debt or liability. The promise to pay in the articles of Central Capital is not made independent of any ability to pay.

97 In the event that I am wrong in my conclusion that the true nature of the relationship is one of equity, I shall now consider the position in the event that a debt has been created.

3. If the nature of the relationship is not an equity relationship are the appellants entitled to be claimants under the CCAA.?

98 The parties agree that the effect of s. 36 renders the agreement to redeem their preferred shares unenforceable. It is the position of the appellants, however, that s. 36 does not extinguish Central Capital's obligation to repay them. Their position is that Central Capital's obligation to repay them is a contingent liability and therefore gives them a claim provable in bankruptcy, bringing them under s. 12(1) of the *CCAA*.

The Meaning of Debt

99 Debt is defined in a very broad manner in *Black's Law Dictionary*, 6th ed. (1990) at p. 403. It is the position of the appellants that this definition of "debt" is broad enough to include McCutcheon's right to have Central Capital redeem his shares. In the case of SYH, it is submitted that the right to redemption constitutes a future liability. It is the appellants' position that Feldman J. erred in holding that to have a provable claim, McCutcheon and Central Capital must be able to obtain a judgment against Central Capital for the retraction price and be entitled to seek payment on the judgment. Finlayson J.A. agrees with the appellant's position.

100 Debt is defined in *Black's Law Dictionary, supra*, as:

> A sum of money due by certain and express agreement. A specified sum of money owing to one person from another, including not only obligation of debtor to pay but right of creditor to receive and enforce payment.
>
> A fixed and certain obligation to pay money or some other valuable thing or things, either in the present or in the future. In a still more general sense, that which is due from one person to another, whether money, goods, or services. In a broad sense, any duty to respond to another in money, labour, or service; it may be even a moral or honorary obligation, unenforceable by legal action. Also, sometimes an aggregate of separate debts, or the total sum of the existing claims against person or company. Thus we speak of the "national debt", the "bonded debt" of a corporation, etc.

101 It will be readily apparent that in *Black's* the term "debt" is defined in two distinct ways. In order to constitute a debt as defined in the first paragraph, the obligation must be enforceable. In the second paragraph debt is defined more broadly as any duty or obligation even if unenforceable by legal action. Feldman J. considered the first portion of the definition in her reasons. If the first portion of the definition applies, no debt is created because the obligation is not enforceable under the *CBCA*. The appellants rely on the second portion of the definition. They also rely on the definition of of the word "liability" in *Black's* which is also defined very broadly.

102 In one sense, support for the position of the appellants is found in s. 40 of the *CBCA*. Section 40 states that a contract with a corporation providing for the purchase of shares of the corporation is specifically enforceable against the corporation except to the extent that the corporation cannot perform the contract without being in breach of ss. 34 or 35. Section 34 contains the solvency requirements concerning the redemption by a company of its own shares other than those carrying a right of redemption. Section 35 deals with shares which have been issued to settle or compromise a debt. In s. 2, "liability" is defined as including "a *debt* of a corporation arising under section 40 ... ."

103 Section 40 does not include any reference to the obligation of a company to repurchase redeemable shares under s. 36. As a result s. 36 is not incorporated by reference into the definition of liability. While it might be suggested that this is a legislative oversight, the omission is also consistent with the position that only the articles of the corporation govern the relationships between the company and the holders of the retractable shares under s. 36. I have already stated my opinion that the articles of Central Capital do not make the obligation to redeem the shares a debt or, for that matter, a liability. Moreover, even if a provision like s. 40 is implied with respect to redeemable preferred shares, it would also be necessary to imply a provision like s. 40(3) which states that in the event of liquidation where the company has not performed its contract to redeem, the other party is entitled to be ranked subordinate to the rights of creditors but in priority to the shareholders. This is a clear expression of legislative intention that on insolvency the claim of those entitled to have their shares redeemed should not be placed on the same footing with the claims of creditors but should rank subordinate to them: see *Nelson v. Rentown Enterprises Inc.*, [1994] 4 W.W.R. 579 (Alta. C.A.), adopting the reasons of Hunt J. at (1992), 96 D.L.R. (4th) 586 (Alta. Q.B.). Policy reasons would again militate in favour of the result being the same on a reorganization.

Claims in Bankruptcy

104 Even if the broader definitions of a debt or liability in *Black's* are adopted, the appellants still do not have a claim provable in bankruptcy.

105 Persuasive authority already exists to the effect that in order to be a provable claim within the meaning of s. 121 of the *Bankruptcy and Insolvency Act* the claim must be one recoverable by legal process: *Farm Credit Corp. v. Holowach (Trustee of)*, [1988] 5 W.W.R. 87 (Alta. C.A.) at 90, leave to appeal to the Supreme Court of Canada dismissed at [1989] 4 W.W.R. lxx (note).

106 In *Holowach*, the seven members of the court were dealing with a situation in which some persons borrowed money from a mortgagee and mortgaged certain lands as security for repayment of the loan. The mortgagors then made an assignment in bankruptcy. The mortgagee filed a proof of claim for the full amount of the deficiency, that is, the amount of the indebtedness less the value of the land which the mortgagee was permitted to purchase. The Alberta *Law of Property Act*, R.S.A. 1980, c. L-8, precluded deficiency claims against individuals in foreclosure actions, although the effect of the legislation was not to extinguish or satisfy the debt. The mortgagee argued that it had a claim provable in bankruptcy under s. 95(1), now s. 121(1), of the *Bankruptcy and Insolvency Act*. The court rejected this argument, holding that a provable claim must be one recoverable by legal process. In coming to its conclusion, the court relied on *Reference re Debt Adjustment Act, 1937 (Alberta)*, [1943] 1 All E.R. 240 (P.C.), and a number of decisions at the trial level which are collected at p. 91 of the decision.

107 Here, the contract to repurchase the shares, while perfectly valid, is without effect to the extent that there is a conflict between the corporation's promise to redeem the shares and its statutory obligation under s. 36 of the *CBCA* not to reduce its capital where it is insolvent. As was the case in the *Holowach* decision, this statutory overlay renders Central Capital's promise to redeem the appellants' preferred shares unenforceable. Although there is a right to receive payment, the effect of the solvency provision of the *CBCA* means that there is no right to enforce payment. Inasmuch as there is no right to enforce payment, the promise is not one which can be proved as a claim.

108 It could be suggested that the decision in *Holowach* can be distinguished from the instant case on the basis that in *Holowach* the claim is made unenforceable forever by statute whereas under the *CCAA* the claim is unenforceable only so long as the corporation does not meet the solvency requirements of s. 36 of the *CBCA*. I do not believe this is a valid distinction for three reasons. First, the relevant date for determining any contingent liability is not the future but the past, namely, September 8, 1992, the date by which proofs of claim had to be submitted. On that date, Central Capital was insolvent. Second, it is only because the lenders were willing to convert their debt obligations into equity in the reorganization that Central Capital is now solvent. Central Capital is not the same company and its liabilities are not the same. The redeemable shares no longer exist. Third, in order to be profitable, the assets of a company must be managed. Any value in the assets after the insolvency of the company is, in this case, due to the new management and not to the preferred shareholders extending credit to the company by having their claim for redemption postponed.

109 Even if Central Capital's obligation to redeem the shares of the appellants created a debt or liability, the appellants do not have a claim provable within the meaning of s. 121 of the *Bankruptcy and Insolvency Act*.

Conclusion

110 I would dismiss the appeal. For the reasons I have given, the retraction amounts do not constitute a debt or liability within the meaning of s. 121 of the *Bankruptcy and Insolvency Act*. Even if I am wrong in my conclusion and a debt or liability is created, it is not a claim within the meaning of the *CCAA*. This is a case of first impression. For these reasons, I would not award any costs of this appeal.

Laskin J.A. **(concurring):**

111 I have read the reasons of my colleagues Justice Finlayson and Justice Weiler. Like Justice Weiler, I would affirm the decision of the motions judge, Feldman J., and dismiss these appeals. I prefer, however, to state my own reasons for upholding the position of the unsecured creditors of Central Capital Corporation.

The Issue

112 The application was argued before Madam Justice Feldman on an agreed statement of facts. My colleagues have summarized the relevant facts and important provisions of the documents. Each appellant holds preferred shares of Central Capital and each appellant's shares contain a right of retraction — a right to require Central Capital to redeem the shares on a fixed date and for a fixed price. The retraction date for the appellants James McCutcheon and Central Guarantee Trust Company (collectively McCutcheon) was July 1, 1992, and before that date McCutcheon exercised his right of retraction and tendered his shares for redemption. The retraction date for the appellant S.Y.H. Corporation was September 1994 and although it could not render its shares for redemption, it did file a proof of claim with the Administrator of Central Capital. The Administrator disallowed each appellant's claim and Feldman J. dismissed appeals from the Administrator's decisions.

113 The issue on these appeals is whether McCutcheon and S.Y.H. Corporation "have claims provable against Central Capital Corporation within the meaning of the *Bankruptcy Act (Canada)* as amended as of the date of the Restated Subscription and Escrow Agreement." Under the *Bankruptcy Act*, R.S.C. 1985, c. B-3, s. 2, a claim provable "includes any claim or liability provable in proceedings under this Act by a creditor" and a creditor "means a person having a claim, preferred, secured or unsecured, provable as a claim under this Act." Section 121(1) of the *Bankruptcy Act* further defines claims provable as follows:

> *121.* (1) All debts and liabilities, present or future, to which the bankrupt is subject at the date of the bankruptcy or to which he may become subject before his discharge by reason of any obligation incurred before the date of the bankruptcy shall be deemed to be claims provable in proceedings under this Act.

114 The date of the Restated Subscription and Escrow Agreement is May 1992. [1] By then, and indeed since December 1991, Central Capital had been insolvent and therefore was prohibited by s. 36(2) of the *Canada Business Corporations Act*, R.S.C. 1985, c. C-44, from making any payment to redeem the appellants' shares.

115 On June 15, 1992, Houlden J. provided that Central Capital could be reorganized under the *Companies' Creditors Arrangement Act*, R.S.C. 1985, c. C-36 and he stayed proceedings against it. Houlden J.'s order of July 9, 1992, which approved the restructuring of Central Capital, was made without prejudice to the right of the appellants to assert claims as creditors. Thus the question for this court is whether the appellants' retraction rights created debts of Central Capital in May, 1992. In other words were McCutcheon and S.Y.H. Corporation creditors of Central Capital in May, 1992? If they were creditors, then like the other unsecured creditors of Central Capital, they can elect to take shares in the newly incorporated company, Canadian Insurance Group Limited; if they were not creditors, then they remain shareholders of Central Capital under the restructuring plan.

116 This is a question of characterization. I will address the question first, by considering the "substance" of the relationship between each appellant and the company; and second by considering s. 36(2) of the *Canada Business Corporations Act, supra*. In brief I conclude:

> (1) Although the relationship between each appellant and the company has characteristics of debt and equity, in substance both McCutcheon and S.Y.H. Corporation are shareholders, not creditors of Central Capital. Neither the existence of their retraction rights nor the exercise of those rights converts them into creditors;
>
> (2) Finding that the appellants were creditors of Central Capital would defeat the purpose of s. 36(2) of the statute.

I. The Relationship between the Appellants and Central Capital

117 Preferred shares have been called "compromise securities" and even "financial mongrels": Grover and Ross, *Materials and Corporate Finance* (1975), at p. 49. Invariably the conditions attaching to preferred shares contain attributes of equity and, at least in an economic sense, attributes of debt. Over the years financiers and corporate lawyers have blurred the distinction between equity and debt by endowing preferred shareholders with rights analogous to the rights of creditors. One example is the right of redemption — the right of the corporation to compel preferred shareholders to sell their shares back to the corporation. Another example, and it is the case before us, is the right of retraction — the right of shareholders to compel the corporation to buy back their shares on a specific date for a specific price.

118 I acknowledge, therefore, that redeemable or retractable preferred shares are somewhat different from conventional equity capital. What makes the appeals before us difficult is that although the appellants appear to hold equity, their right of retraction appears to be a basic characteristic of a debtor-creditor relationship. See Grover and Ross, *supra*, at pp. 47-49; Buckley, Gillen and Yalden, *Corporations: Principles and Policies*, 3rd ed. (1995), at pp. 938-940.

119 If the certificate or instrument contains features of both equity and debt — in other words if it is hybrid in character — then the Court must determine the "substance" of the relationship between the holder of the certificate and the company. This is the lesson of Justice Iacobucci's judgment in *Canada Deposit Insurance Corp. v. Canadian Commercial Bank*, [1992] 3 S.C.R. 558. In that case the Supreme Court of Canada had to determine whether the financial assistance given by several lending institutions to try to rescue the Canadian Commercial Bank was "in the nature of a loan" or "in the nature of a capital investment." Justice Iacobucci discussed his approach to the problem at pp. 590-591 of his judgment:

> As I see it, the fact that the transaction contains both debt and equity features does not, in itself, pose an insurmountable obstacle to characterizing the advance of $255 million. Instead of trying to pigeonhole the entire agreement between the Participants and CCB in one of two categories, I see nothing wrong in recognizing the arrangement for what it is, namely, one of a hybrid nature, combining elements of both debt and equity but which, in substance, reflects a debtor-creditor relationship. Financial and capital markets have been most creative in the variety of investments and securities that have been fashioned to meet the needs and interests of those who participate in those markets. It is not because an agreement has certain equity features that a court must either ignore these features as if they did not exist or characterize the transaction on the whole as an investment. There is an alternative. It is permissible, and often required, or desirable, for debt and equity to co-exist in a given financial transaction without altering the substance of the agreement. Furthermore, it does not follow that each and every aspect of such an agreement must be given the exact same weight when addressing a characterization issue. Again, it is not because there are equity features that it is necessarily an investment in capital. This is particularly true when, as here, the equity features are nothing more than supplementary to and not definitive of the essence of the transaction. When a court is searching for the *substance* of a particular transaction, it should not too easily be distracted by aspects which are, in reality, only incidental or secondary in nature to the main thrust of the agreement.

120 In determining the substance of the relationship, as in any other case of contract interpretation, the court looks to what the parties intended. In *CDIC v. CCB, supra*, Iacobucci J. put this proposition as follows at p. 588:

> As in any case involving contractual interpretation, the characterization issue facing this Court must be decided by determining the intention of the parties to the support agreements. This task, perplexing as it sometimes proves to be, depends primarily on the meaning of the words chosen by the parties to reflect their intention. When the words alone are insufficient to reach a conclusion as to the true nature of the agreement, or when outside support for a particular characterization is required, a consideration of admissible surrounding circumstances may be appropriate.

121 In these appeals what the parties intended is reflected mainly in the share purchase agreements and the conditions attaching to the appellants' shares, but also in the articles of incorporation and in the way Central Capital recorded the

appellants' shares in its financial statements. These documents indicate that in substance the appellants are shareholders of Central Capital, not creditors. I rely on the following considerations to support my conclusion:

122 (i) Both appellants agreed to take preferred shares instead of some other instrument — for example, a bond or debenture — that would obviously have made them creditors. The appellant McCutcheon sold shares of one corporation (Canadian General Securities Limited) for cash and for shares of another corporation (Central Capital). Neither the share purchase agreements nor the share conditions support McCutcheon's contention that in taking preferred shares he was extending credit to Central Capital by deferring payment of the purchase price. He made an investment in the capital of Central Capital, no doubt because of the attractive dividend rate, the income tax advantages of preferred shares and "sweeteners" such as conversion privileges. Unlike Finlayson J.A., I place little weight on what he termed "the unique nature of the transaction". McCutcheon transferred assets to acquire his preferred shares rather than acquiring them with cash. But he nonetheless decided to invest in Central Capital and to take the risk and the profits (through dividends) of his investment.

123 Similarly, S.Y.H. Corporation exchanged its equity investment in four insurance companies for an equity investment in Central Capital. It too chose equity not debt. None of the contractual documents indicates that the appellants' retraction rights were intended to trigger an obligation on the part of Central Capital to repay a loan. Moreover, as Weiler J.A. points out, neither the share purchase agreements nor the share conditions provides for interest if Central Capital fails to honour its retraction obligations.

124 (ii) The senior preferred shares and junior preferred shares that the appellants own were part of the authorized capital of Central Capital before the appellants acquired them.

125 (iii) The appellants' shares were recorded in the financial statements of Central Capital as "capital stock," along with the company's issued and outstanding common shares, class "A" shares and warrants. The amount Central Capital might be obligated to pay the appellants if they exercised their retraction rights was not recorded as debt (even contingent debt) in the company's financial statements.

126 (iv) Both appellants had the right to receive dividends on their shares and McCutcheon had the right to vote his shares for the election of directors of Central Capital if dividends remained unpaid for a specified time. These rights — to receive dividends and to vote — are well recognized rights of shareholders. And these rights continue, even after the retraction dates, until the appellants' shares are redeemed.

127 (v) The preferred share conditions provide that on a liquidation, dissolution or winding up, the holders rank with other shareholders and therefore, implicitly, behind creditors. The appellant McCutcheon, who holds senior preferred shares, would rank behind creditors but ahead of the holders of subordinate classes of shares; the appellant S.Y.H. Corporation, which holds junior preferred shares, would rank behind senior preferred shareholders but ahead of common shareholders.

128 These provisions in the preferred share conditions also state that on payment of the amount owing to them the appellants "shall not be entitled to share in any further distribution of assets of the corporation." Finlayson J.A. interprets this to mean that the appellants "are not entitled to be treated as shareholders under a winding up or a liquidation but only as creditors." I disagree. These are typical preferred share provisions, which limit the recovery of the holders but do not treat them as creditors: *Sutherland et al., Fraser & Stewart Company Law of Canada*, 6th ed. (1993), at p. 198. At least on a liquidation, dissolution or winding up, the preferred share conditions evidence that the appellants would be treated not as creditors but as shareholders. In *CDIC v. CCB, supra*, Iacobucci J. placed considerable weight on a provision in the Participation Agreement stating that each participant "shall rank *pari passu* with the rights of the depositors." No such provision exists in this case. Indeed the share conditions I have referred to state the opposite.

129 Of course, Central Capital was reorganized, not liquidated, dissolved or wound up and the preferred share conditions are silent about what occurs on a reorganization. Still these conditions shed light on what the parties

intended on the reorganization. Section 12(1) of the *Companies' Creditors Arrangement Act, supra*, defines claim as "any indebtedness, liability or obligation of any kind that, if unsecured, would be a debt provable in bankruptcy within the meaning of the *Bankruptcy Act*." The question the court has been asked to answer is the same question that would arise on a liquidation. It is illogical to conclude that the appellants could claim only as shareholders on a liquidation and yet can claim as creditors on the reorganization. Whether Central Capital's financial difficulties led to a liquidation or a reorganization, the issue is the same and the analysis and the result should also be the same.

130 The appellants argue, however, that they are shareholders only until they exercise their retraction rights but once they exercise these rights they become creditors. I do not agree with this argument. The share conditions provide that even after exercising their retraction rights, the appellants continue to be entitled to dividends and to vote until their shares are redeemed. In other words, they continue to enjoy the rights of shareholders. Moreover, if when the appellants exercised their retraction rights the company were insolvent and were to be subsequently liquidated (or dissolved or wound up), the appellants would rank as shareholders on the liquidation. And as I have indicated above the result should be no different on the reorganization.

131 It seems to me that these appellants must be either shareholders or creditors. Except for declared dividends, they cannot be both. Once they are characterized as shareholders, their rights of retraction do not create a debtor-creditor relationship. These rights enable them to call for the repayment of their capital on a specific date (and at an agreed upon price) provided the company is solvent. Ordinarily shareholders have to recoup their investment by selling their shares to third parties. If they have retraction rights, however, they can compel the company (if solvent) to repay their investment at a given time for a given price. But the right of retraction provides for the return of capital not for the repayment of a loan. Certainly the *Canada Business Corporations Act* treats a redemption of shares as a return of capital because s. 39 of the statute requires a company on a redemption to deduct from its stated capital account an amount equal to the value of the shares redeemed. The shares redeemed are then either cancelled or returned to the status of authorized but unissued shares.

132 Putting it differently, a preferred shareholder exercising a right of retraction on the terms that exist here must rank behind the company's creditors. Grover and Ross make this point more generally in their *Materials and Corporate Finance, supra*, at pp. 48-49:

> On the other hand, the company cannot issue "secured" preferred shares in the sense that shares cannot have a right to a return of capital which is equal or superior to the rights of creditors. Preferred shareholders are risk-takers who are required to invest capital in the business and who can look only to what is left after creditors are fully provided for. Thus, in the absence of statutory authorization, the claims of shareholders cannot be secured by a lien on the corporate assets. They rank behind creditors but before com mon shareholders (if specified) on a voluntary or involuntary dissolution of the company.

133 Admittedly there is little authority in Canada on the issue confronting this court. Some of the cases that the respondent relies on — for example, *Re Patricia Appliance Shops Ltd.* (1922), [1923] 3 D.L.R. 1160 (Ont. S.C.), *Laronge Realty Ltd. v. Golconda Investments Ltd.* (1986), 63 C.B.R. (N.S.) 76 (B.C. C.A.), and even *Re Meade (Debtor); Ex parte Humber v. Palmer (Trustee)* [1951], 2 All E.R. 168 (P.C.) — are of limited assistance because the shareholders in those cases did not have retraction rights.

134 Perhaps the closest case — and the appellants rely heavily on it — is the judgment of the British Columbia Court of Appeal in *Re East Chilliwack Agricultural Co-op.* (1989), 74 C.B.R. (N.S.) 1. In that case a majority of the court (Craig J.A. dissenting) held that a withdrawing member of a co-operative association who elected to have his shares redeemed in instalments over a five-year period should be treated on the subsequent bankruptcy of the association as an ordinary creditor rather than as a shareholder. I decline to apply *East Chilliwack* for three reasons. First, because the case was decided in 1989, the British Columbia Court of Appeal did not have the benefit of the Supreme Court of Canada's reasons in *CDIC v. CCB, supra*. In *East Chilliwack* Hutcheon J.A., writing for the majority did not focus on what the parties intended when the member contracted with the co-operative. Instead he only considered the relationship between the

member and the co-operative after the member had withdrawn. I do not think his approach is consistent with Justice Iacobucci's judgment in *CDIC v. CCB, supra*.

135 Second, there are important factual differences between *East Chilliwack* and the appeals before us. Justice Weiler has referred to these factual differences in her reasons. The most important of these differences are the following: in *East Chilliwack* the rules of the association provided that a member had to withdraw from the association to trigger the right of redemption, whereas the appellants' share conditions provide that they continue to be shareholders of Central Capital until their shares are redeemed; in *East Chilliwack* the member elected to withdraw and redeem his shares when the association was solvent whereas when the appellant McCutcheon exercised his right of retraction Central Capital was insolvent; and in *East Chilliwack* Hutcheon J.A. expressly stated that he was not considering the effect of the superintendent's power to suspend payments if the financial position of the co-operative was impaired, whereas the effect of the statutory prohibition against Central Capital making payment, found in s. 36(2) of the *Canada Business Corporations Act*, is in issue in these appeals.

136 Third, the decision in *East Chilliwack* is at odds with most of the American case law and I favour the American approach. When a company repurchases shares by instalment and bankruptcy intervenes, the prevailing American position is that the shareholder's claim is deferred to the claims of ordinary creditors. The decision of the Fifth Circuit Court of Appeals in *Robinson v. Wangemann*, 75 F.2d 756 (Tex. 1935) is frequently cited. The facts of that case are virtually identical to the facts in *East Chilliwack*. A company had agreed to repurchase a stockholder's stock by instalments. Although the company was solvent when the agreement was made it went bankrupt before the repurchase was completed. The stockholder sought to prove as an ordinary creditor for the unpaid purchase price. Foster, Circuit Judge, writing for a unanimous court rejected the stockholder's claim at p. 757:

> A transaction by which a corporation acquires its own stock from a stockholder for a sum of money is not really a sale. The corporation does not acquire anything of value equivalent to the depletion of its assets, if the stock is held in the treasury, as in this case. It is simply a method of distributing a proportion of the assets to the stockholder. The assets of a corporation are the common pledge of its creditors, and stockholders are not entitled to receive any part of them unless creditors are paid in full. When such a transaction is had, regardless of the good faith of the parties, it is essential to its validity that there be sufficient surplus to retire the stock, without prejudice to creditors, at the time payment is made out of assets.

137 At the heart of *Robinson v. Wangemann* is the finding that the selling stockholder is not a creditor in the sense of a person who loans money to a corporation, and therefore is not entitled to parity with the general creditors. The principle in *Robinson v. Wangemann* seeks to protect creditors by refusing to permit selling stockholders, who were risk investors, to withdraw their capital on the same terms as general creditors in the event of insolvency. Section 40(3) of the *Canada Business Corporations Act* — a section to which I shall return when considering s. 36(2) of the same statute — codifies the principle in *Robinson v. Wangemann* for share repurchases, though not for share redemptions. See also Blumberg, *The Law of Corporate Groups* (1989), at pp. 205-210 and see *contra Wolff v. Heidritter Lumber Co.*, 163 A. 140 (N.J. Ch. 1932).

138 Quite apart from the instalment purchase price cases, American courts have often grappled with the question whether preferred stockholders can claim as creditors of the corporation. Although there are cases going both ways, most appear to come to the same conclusion as I do. The American cases are collected in Bjor and Solheim, *Fletcher Cyclopedia of the Law of Private Corporations* (1995), revised vol. 11 and in Bjor and Reinholtz, *Fletcher Cyclopedia of the Law of Private Corporations* (1990), revised vol. 15A. In volume 11 the authors of the text indicate — as did the Supreme Court of Canada in *CDIC v. CCB* — that "[w]hether or not the holder of a particular instrument or certificate is to be regarded as a shareholder or a creditor is a question of interpretation, and depends on the terms of the contract as evidenced by the instrument, the articles of incorporation, and the statutes of the state. The nature of the transaction is to be determined by the real substance and effect of the contract rather than by the name given to the obligations or its form ..." (at p. 566).

139 And in volume 15A the authors state at pp. 290 and 292 that even the arrival of a fixed redemption date does not change a preferred stockholder into a creditor:

> Holders of preferred stock of a corporation, in the absence of express provision to the contrary, are stockholders and not creditors of the corporation, except for dividends declared. They have no lien upon, and are not entitled to, any of the assets of the corporation when it becomes insolvent, until all debts are paid. Furthermore, there is authority that the status of a preferred stockholder is not changed to that of creditor, even though a dividend is guaranteed. Indeed it is beyond the power of a corporation to issue a class of stock, the holders of which are entitled to preference over general creditors.
>
> . . . . .
>
> Even where preferred stock has a fixed redemption date, arrival of that date does not change the status of a preferred stockholder to that of a creditor. (pp. 290, 292)

140 I agree with these statements. I therefore conclude first that the appellants, in substance, were shareholders of Central Capital not creditors; and second that neither the existence nor the exercise of their retraction rights turned them into creditors.

II. Provable Claims and Section 36(2) of the Canada Business Corporations Act

141 In May 1992 Central Capital was insolvent. It was unable to pay its liabilities as they became due and the realizable value of its assets was less than the aggregate of its liabilities. Because it was insolvent it was prohibited by s. 36(2) of the *Canada Business Corporations Act* from redeeming the appellants' shares. Section 36(2) of the statute provides:

> (2) A corporation shall not make any payment to purchase or redeem any redeemable shares issued by it if there are reasonable grounds for believing that
>
> (*a*) the corporation is, or would after the payment be, unable to pay its liabilities as they become due; or
>
> (*b*) the realizable value of the corporation's assets would after the payment be less than the aggregate of
>
> (i) its liabilities, and
>
> (ii) the amount that would be required to pay the holders of shares that have a right to be paid, on a redemption or in a liquidation, rateably with or prior to the holders of the shares to be purchased or redeemed.

142 As well, the appellants' share conditions provide that they are not permitted to redeem their shares if to do so would be "contrary to applicable law," in this case s. 36(2) of the statute.

143 To hold that the appellants have provable claims would defeat the purpose of s. 36(2) of the *Canada Business Corporations Act*. At common law a company could not repurchase its own shares on the open market or in the language of *Trevor v. Whitworth* (1887), 12 App. Cas. 409 (H.L.), a company could not "traffick in its own shares." The obvious reason was to prevent companies from using their assets to destroy the claims of their creditors. Modern corporate statutes, such as the *Canada Business Corporations Act*, modified the rule in *Trevor v. Whitworth* to permit repurchases provided the company's creditors would not be prejudiced. Thus the legislation insisted that the company could not repurchase its own shares unless it satisfied stated solvency tests. And so, s. 34(2) of the *Canada Business Corporations Act* provides:

> (2) A corporation shall not make any payment to purchase or otherwise acquire shares issued by it if there are reasonable grounds for believing that
>
> (*a*) the corporation is, or would after the payment be, unable to pay its liabilities as they become due; or

> (*b*) the realizable value of the corporation's assets would after the payment be less than the aggregate of its liabilities and stated capital of all classes.

144 In *Nelson v. Rentown Enterprises Inc.* (1992), 96 D.L.R. (4th) 586 (Alta. Q.B.), affirmed (1994), 109 D.L.R. (4th) 608 (Alta. C.A.), Hunt J. of the Alberta Queen's Bench wrote at p. 589:

> The policy behind the s. 34(2) limitation upon a corporation's power to purchase its own shares seems obvious. It is intended to ensure that one or more shareholders in a corporation do not recoup their investments to the detriment of creditors and other shareholders. It has been observed that:
>
>> Corporate power to purchase its own stock has been frequently abused. Done by corporations conducting faltering businesses, it has been employed to create preferences to the detriment of creditors and of the other stockholders.
>
> *(Mountain State Steel Foundries, Inc. v. C.I.R., supra, at p. 741* [284 F.2d 737 (1960)].*)*
>
> Modern business statues permit these share purchases to take place provided that the position of creditors and other shareholders is protected, by virtue of the application of the s. 34(2) tests.

145 Redemptions of preferred shares, unlike repurchases, were always permitted at common law as long as they were not made in contemplation of bankruptcy. But the solvency test in s. 36(2) of the *Canada Business Corporations Act* has the same purpose as the solvency test in s. 34(2): to prevent redemptions if they would allow the company to prejudice the claims of creditors. See Buckley *et al., Corporations: Principles and Policies, supra*, at pp. 968-71. To hold that the appellants' retraction rights gave rise to provable claims in the face of s. 36(2), thereby allowing the appellants to rank equally with the unsecured creditors, would undermine the purpose of the section. If a claim in a bankruptcy or reorganization proceeding is unenforceable under the statute, the claim is not entitled to recognition on a parity with the claims of unsecured creditors: See *Blumberg, supra*, at pp. 205-6; and *Farm Credit Corp. v. Holowach (Trustee of)* (1988), 68 C.B.R. (N.S.) 255 (Alta. C.A.).

146 I draw comfort in this conclusion from s. 40 of the *Canada Business Corporations Act*. Section 40(1) provides that a contract with a corporation for the purchase of its shares is specifically enforceable against the corporation "except to the extent that the corporation cannot perform the contract without thereby being in breach of section 34 ..." Section 40(3) then states:

> (3) Until the corporation has fully performed a contract referred to in subsection (1), the other party retains the status of a claimant entitled to be paid as soon as the corporation is lawfully able to do so or, in a liquidation, to be ranked subordinate to the rights of creditors but in priority to the shareholders.

147 In other words, the section recognizes that if a company contracts to repurchase its shares but is prohibited from doing so because it is insolvent, the vendor of the shares is not a creditor and on a liquidation ranks subordinate to the rights of creditors. The shareholder cannot be repaid at the expense of the company's creditors. Although s. 40 does not expressly apply to s. 36, I think that the rationale for s. 40(3) applies to redemptions as well as to repurchases. Whether a repurchase or a redemption, the shareholder is not a creditor and is subordinate to the rights of creditors. More simply the shareholder does not have a provable claim.

148 The appellants rely on *National Bank für Deutschland v. Blucher*, *(*sub nom. *Blucher v. Canada (Custodian))* [1927] 3 D.L.R. 40 (S.C.C.), but in my view this case does not assist them. In *Blucher* dividends were declared on stock but payment of the dividends was suspended during World War I. The Supreme Court of Canada held at p. 43 that "[t]he right of recovery was in suspense during the war, but the debt nevertheless existed." In that case, however, the dividend was declared before the suspension of payment took place. Moreover, as Justice Finlayson points out in his reasons,

courts have always accepted the proposition that when a dividend is declared it is a debt on which each shareholder can sue the corporation.

149 Holding that the appellants do not have provable claims accords with sound corporate policy. On the insolvency of a company the claims of creditors have always ranked ahead of the claims of shareholders for the return of their capital. Case law and statute law protect creditors by preventing companies from using their funds to prejudice creditors' chances of repayment. Creditors rely on these protections in making loans to companies. Permitting preferred shareholders to be turned into creditors by endowing their shares with retraction rights runs contrary to this policy of creditor protection.

150 I would dismiss these appeals. I would not make any cost order. I am grateful to all counsel for their assistance on this interesting and difficult problem.

Appeals dismissed.

Footnotes

1 There is a discrepancy in the materials before this court on the relevant date for establishing a claim provable against Central Capital: S.Y.H. Corporation used May, 1992, the date of the Restated Subscription and Escrow Agreement whereas McCutcheon and the unsecured creditors of Central Capital Corporation used June 15, 1992, the date of the court-ordered stay of proceedings against Central Capital. I have used the May 1992 date but nothing turns on the use of this date as opposed to the June 15, 1992 date.

39

1992 CarswellAlta 298
Supreme Court of Canada

Canada Deposit Insurance Corp. v. Canadian Commercial Bank

1992 CarswellAlta 298, 1992 CarswellAlta 790, [1992] 3 S.C.R. 558, [1992] S.C.J. No. 96, [1993] A.W.L.D. 003, 131 A.R. 321, 143 N.R. 321, 16 C.B.R. (3d) 14, 16 C.B.R. (3d) 154, 25 W.A.C. 321, 36 A.C.W.S. (3d) 731, 5 Alta. L.R. (3d) 193, 7 B.L.R. (2d) 113, 97 D.L.R. (4th) 385, J.E. 92-1742, EYB 1992-66961

Re Winding-up Act, R.S.C. 1970, c. W-10, as amended; Re Winding-up of CANADIAN COMMERCIAL BANK; PRICE WATERHOUSE LIMITED (Liquidator of CANADIAN COMMERCIAL BANK) v. R. IN RIGHT OF ALBERTA, ROYAL BANK OF CANADA, BANK OF MONTREAL, TORONTO-DOMINION BANK, BANK OF NOVA SCOTIA, CANADIAN IMPERIAL BANK OF COMMERCE and NATIONAL BANK OF CANADA

La Forest, L'Heureux-Dubé, Gonthier, Cory, McLachlin, Stevenson * and Iacobucci JJ.

Heard: April 2, 1992
Judgment: November 19, 1992
Docket: Doc./n[o] 22084

Counsel: *Charles P. Russell*, for liquidator
Earl A. Cherniak, Q.C., and *Robert J. Morris*, for general body of creditors of estate of Canadian Commercial Bank
James Rout, Q.C., for respondent R. in Right of Alberta.
Colin L. Campbell, Q.C., for respondents Royal Bank of Canada, Bank of Montreal, Toronto-Dominion Bank, Bank of Nova Scotia, Canadian Imperial Bank of Commerce and National Bank of Canada

Subject: Corporate and Commercial; Insolvency

Headnote

Banking and Banks --- Termination of business by bank — On insolvency of bank — Priority of claims against bank assets

Partnership --- Accounting — Upon dissolution

Corporations — Winding-up — Several parties advancing funds in attempt to save chartered bank from insolvency — Attempt failing and bank ordered wound up — Funds advanced being characterized as loan and not capital investment — Group of lenders being entitled to rank equally with bank's unsecured creditors.

When a chartered bank found itself in financial difficulty, an arrangement to provide emergency financial assistance to the bank was entered into by the governments of Canada and of Alberta, six major Canadian financial institutions, the Canada Deposit Insurance Corporation ("CDIC") and the bank. Under the arrangement $255 million was advanced to the bank by way of a purchase of participation in a portfolio of assets held by the bank. The portfolio of assets consisted of loans and related security having a nominal value on the bank's books of over $500 million. The participation interest of each participant was proportional to its financial contribution. The bank undertook to indemnify the participants against any loss experienced under the support programme up to the amount paid by each of them to the bank. It was agreed that in the event of the insolvency or winding-up of the bank any amount remaining unpaid "shall constitute indebtedness of [the bank] to the members of the Support Group."

Despite this infusion of money, the bank became insolvent and was ordered to be wound up under the *Winding-up Act* in September 1985. A liquidator was appointed.

By August 1987, the liquidator had recovered approximately $112 million on account from the bank's portfolio assets, $5 million of which was attributable to the portion of the assets beneficially owned by the participants. The liquidator brought an application for the advice and direction of the court as to the interpretation of the support agreements. A judge of the Queen's Bench determined that the participants were entitled to the repayment of the $5 million recovered by the liquidator, but were otherwise not entitled to recover their advances until after all ordinary creditors, including unsecured creditors, were paid in full. The injection of funds by the participants was found to have been a capital investment.

The participants, apart from the Government of Canada and CDIC, successfully appealed the part of the judgment characterizing the funds as a capital investment. The Court of Appeal characterized the advance of $255 million as a loan and concluded that the participants were entitled to rank equally with the bank's unsecured creditors for all moneys advanced to the bank.

The liquidator applied for leave to appeal from the judgment of the Court of Appeal. Leave was granted. On the appeal, the Supreme Court of Canada considered (1) whether the $255 million advance was a loan: (2) if so, whether it was a loan coming within the postponement provision in s. 4 of the *Partnerships Act* (Ont.); and (3) if that Act did not apply, whether the claim of the six financial institutions and the Government of Alberta should be postponed to the claims of the general body of the bank's unsecured creditors, other than the participants, based on the United States doctrine of equitable subordination.

Held:

The appeal was dismissed.

The words chosen by the participants in the agreements covering the advance of the $255 million clearly supported the Court of Appeal's conclusion that the assistance programme involved a loan and not a capital investment. There was nothing in the surrounding circumstances that would alter this characterization. Although the transaction had some "investment features", they were incidental to the debt features of the arrangement and did not alter the substance of the debtor-creditor relationship created by the advance of the $255 million.

The loan did not fall within the ambit of the *Partnerships Act* as the participants were to receive neither a "rate of interest varying with the profits" of the bank, nor a "share of the profits arising from carrying on the business" of the bank. Therefore, the Court of Appeal did not err in declining to postpone the participants' claims under s. 4 of the Act. The participants were not to receive a rate of interest varying with the bank's profits in return for the advance of $255 million. The rate of interest was fixed according to the prime rate and was made contingent on whether or not an equity agreement could be carried out. Further, a lender does not share in profits within the meaning of ss. 3(3)(*d*) and 4 of the Act unless he or she is entitled to be paid amounts referable to profits other than in repayment of the principal amount of the loan. While the repayment was to be made from the pre-tax income of the bank, there was no direct link between the success of the bank and the overall quantum of the amount due to or payable to the participants.

The principles of equitable subordination had no application to the facts of the case. In order to make a successful claim for equitable subordination (1) the claimant must have engaged in some type of inequitable conduct; (2) the misconduct must have resulted in injury to the creditors of the bankrupt or conferred an unfair advantage on the claimant; and (3) equitable subordination of the claim must not be inconsistent with the provisions of the bankruptcy statutes. The evidence adduced disclosed neither inequitable conduct on the part of the participants nor injury to the ordinary creditors of the bank as a result of the alleged misconduct.

. . . . .

Table of Authorities

Cases considered

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British Eagle International Airlines Ltd. v. Compagnie Nationale Air France, [1975] 1 W.L.R. 758, [1975] 2 All E.R. 390 (H.L.) — *referred to*

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Dickie, Re (1924), 5 C.B.R. 214 (N.S. T.D.) — *referred to/mentionné*

Fort, Re; Ex parte Schofield, [1897] 2 Q.B. 495 (C.A.) — *referred to*

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Hildasheim, Re, [1893] 2 Q.B. 357 (C.A.) — *referred to*

Laronge Realty Ltd. v. Golconda Investments Ltd. (1986), 63 C.B.R. (N.S.) 76, 7 B.C.L.R. (2d) 90 (C.A.) — *referred to*

Mason, Re; Ex parte Bing, [1899] 1 Q.B. 810 — *referred to*

Meade, Re, [1951] 1 Ch. D. 774, [1951] 2 All E.R. 168 — *referred to*

Mobile Steel Co., Re, 563 F. 2d 692 (5th Circ., 1977) — *referred to*

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Waugh v. Carver (1793), 2 Hy. Bl. 235, 126 E.R. 525 — *referred to*

Young, Re; Ex parte Jones, [1896] 2 Q.B. 484 — *distinguished*

Statutes considered:

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s. 132

s. 173

s. 174

s. 277

Bankruptcy Act, R.S.C. 1985, c. B-3 —

s. 139

Partnership Act, 1890 (U.K.), 53 & 54 Vict., c. 39 —

s. 2(3)(d)

s. 3

Partnership Act, R.S.O. 1990, c. P.5 —

s. 3(3)(a)

s. 3(3)(b)

s. 3(3)(d)

s. 4

Partnership, 1865, Act to Amend the Law of (U.K.), 28 & 29 Vict., c. 86.

Winding-up Act, R.S.C. 1970, c. W-10.

Winding-up Act, R.S.C. 1985, c. W-11 —

s. 93

s. 94

s. 95

Appeal from judgment reported at (1990), 74 Alta. L.R. (2d) 69, 69 D.L.R. (4th) 1, 107 A.R. 199 (C.A.), allowing appeal from (1987), 67 C.B.R. (N.S.) 136, 56 Alta. L.R. (2d) 244, 46 D.L.R. (4th) 518, 83 A.R. 122 (Q.B.).

The judgment of the court was delivered by *Iacobucci J.*:

1 In September 1985 the Canadian public witnessed what fortunately has been an infrequent occurrence in Canadian banking. Early that month, a chartered bank known as the Canadian Commercial Bank ("C.C.B.") became insolvent and was ordered to be wound up pursuant to the provisions of the *Winding-up Act*, R.S.C. 1985, c. W-11 (formerly R.S.C. 1970, c. W-10). This appeal [from (1990), 74 Alta. L.R. (2d) 69, 69 D.L.R. (4th) 1, 107 A.R. 199, reversing (1987), 56 Alta. L.R. (2d) 244, 67 C.B.R. (N.S.) 136, 46 D.L.R. (4th) 518, 83 A.R. 122] concerns the characterization of the unique and complex financial arrangement entered into by the governments of Canada and of Alberta, six major Canadian financial institutions, the Canadian Deposit Insurance Corporation ("C.D.I.C.") and C.C.B. in the spring of 1985 in an

attempt to prevent its winding-up. The main issue is whether, in substance, the $255 million advanced to C.C.B. under this arrangement was in the nature of a loan, in which case the "lenders" thereof would rank pari passu with the other unsecured creditors of C.C.B., or whether it was in the nature of a capital investment in the business of C.C.B., in which case such unsecured creditors would have priority over the "investors." If the former characterization is adopted, as I believe it should be, subsidiary issues concerning the postponement of claims under s. 4 of the *Partnerships Act*, R.S.O. 1990, c. P.5, and the doctrine of equitable subordination are also raised.

I. Facts

2 Although they are relatively uncomplicated, the facts of this case are rather extensive and warrant a full review. C.C.B. was a chartered bank involved primarily in commercial lending. In early 1985 C.C.B. faced a solvency crisis owing to a sharp deterioration in its loan portfolio. Many of its outstanding loans had become non-performing. On March 14, 1985 C.C.B.'s chief executive officer reported this crisis to the Office of the Inspector General of Banks and announced the inability of C.C.B. to continue in operation without outside assistance. At the request of the governor of the Bank of Canada, a government and banking industry funded support initiative was undertaken to assist C.C.B. and to avoid the loss of public confidence in Canada's banking system.

3 On March 24, 1985 a support group comprising Her Majesty in right of Canada ("Canada"), Her Majesty in right of Alberta ("Alberta"), C.D.I.C. and what I shall sometimes refer to as the "bank group," consisting of the Royal Bank of Canada, the Bank of Montreal, the Toronto-Dominion Bank, the Bank of Nova Scotia, the Canadian Imperial Bank of Commerce, and the National Bank of Canada, entered into a memorandum of intent to provide the "emergency financial assistance" requested by C.C.B. "on certain terms."

4 In essence, Canada, Alberta, C.D.I.C. and the bank group, collectively referred to as the "participants," agreed to purchase from C.C.B., at a total price of $255 million, an undivided interest by way of participation in a portfolio of assets held by C.C.B. consisting of loans and related security having a nominal value, on the books of C.C.B., of over $500 million ("portfolio assets"). The participation interest of each participant was proportional to its own financial contribution and was to be evidenced by participation certificates issued by C.C.B. The parties also agreed in principle that the participants would receive from C.C.B. on a proportionate basis, and until such a time as the participants received the amount they paid for their participation certificates, a portion of the money received on account of each portfolio asset as well as 50 per cent of C.C.B.'s pre-tax income, or alternatively 100 per cent of C.C.B.'s pre-tax income plus interest. In other words, it was agreed that the $255 million advanced by the participants would be repaid by C.C.B. After repayment, the payments from the portfolio assets and from C.C.B.'s pre-tax income would cease.

5 Under the memorandum of intent, C.C.B. undertook to indemnify each participant against any loss experienced under the support program up to the amount paid by them to C.C.B. It was agreed that in the event of the insolvency or winding-up of C.C.B., any amount remaining unpaid "shall constitute indebtedness of C.C.B. to the members of the Support Group." Finally, the parties agreed in principle that each participant would receive from C.C.B., on a proportionate basis, transferable rights or warrants to purchase common shares of C.C.B. at a price of $0.25 per share. The warrants were to expire ten years after the day that C.C.B. had repaid the full amount advanced for the participation certificates.

6 On March 25, 1985 the Department of Finance issued a press release announcing a joint agreement involving "an infusion of capital with repayment provisions ... designed to provide the Canadian Commercial Bank with sufficient funds to ensure solvency following a recent and sharp deterioration in its U.S. loan portfolio." The agreement was described as resulting in the "purchase by the support group of a package of nonperforming loans," leaving C.C.B. "in a strong position of solvency in order to support its deposit base." After setting out the general terms of the support program, the Minister of State (Finance) said she had "full confidence" that this program "involving Canada's largest chartered banks and the two Governments will permit the Canadian Commercial Bank to continue its active and important role in the growing economy of Western Canada." The minister concluded that the support program represented "a strong collective vote of confidence in the health of the economy of Western Canada."

7 In order to carry out the letter and spirit of the memorandum of intent, the participants and C.C.B. were to execute, among other documents, a "participation agreement" (also referred to as "P.A."), an "equity agreement" (also referred to as "E.A.") and an "amending and subordination agreement." These agreements, which incorporate and refine the general principles agreed to earlier in the memorandum of intent, were ultimately entered into as of April 29, 1985. The participation agreement and the equity agreement formed the core of the support program. There are no relevant inconsistencies between these documents and the memorandum of intent. I will, however, review in closer detail the former documents as their provisions are of crucial importance to the resolution of the issues raised by this appeal.

8 Section 2 of the participation agreement provided for the participants to purchase from C.C.B., at a total price of $255 million, an undivided interest by way of participation in 255,000,000 units in the portfolio assets of C.C.B. Each participant's interest was proportional to its financial contribution. For example, C.D.I.C. advanced $75 million and received a participation interest in 75,000,000 units. The total participation in the portfolio assets was divided into 529,798,627 units, with the portion of 255,000,000 units purchased by the participants commonly referred to as the "syndicated portion." C.C.B. retained beneficially an undivided participation interest in the remaining 274,798,627 units which comprised the aggregate of the "C.C.B. portion" of the portfolio assets.

9 Under s. 5 of the participation agreement, C.C.B. warranted that the C.C.B. portion for each portfolio asset represented its "best estimate of the amount likely to be recovered from or with respect to that Portfolio Asset." Thus, as found by the learned chambers judge, the participants purchased, in essence, a portfolio of bad loans or that portion of a loan not likely to be recovered.

10 C.C.B. was appointed and authorized to act as agent to ad minister the portfolio assets (P.A. s. 6(a)). Pursuant to s. 9 of the participation agreement, all money received by C.C.B. on account of each portfolio asset, whether principal, interest or otherwise, was first to be retained by C.C.B. until the C.C.B. portion of that portfolio asset was completely recovered; then to be paid to the participants (except C.D.I.C.) proportionately to reduce or retire their respective advances; then to be paid to C.D.I.C. to reduce or retire its proportionate share; and finally to be retained by C.C.B. Each participant was entitled to receive these proceeds up until such time as it received an amount which, when taken together with all amounts received by that participant from C.C.B.'s pre-tax income pursuant to s. 10, was equal to the price paid by that participant for its participation certificate.

11 In addition to proceeds from C.C.B.'s portfolio assets, the participants were entitled to receive proportionately from C.C.B., on a quarterly basis, an amount equal to 50 per cent of C.C.B.'s pre-tax income (P.A. s. 10). C.C.B.'s "pre-tax income" was defined in s. 10 of the participation agreement as C.C.B.'s "net income ... before making any allowance for the payments to be made pursuant to this section, accrued interest on any presently existing bank debenture of CCB or any provision for income taxes payable to Canada, the United States of America and any political division of either." Again, C.C.B.'s obligation to make such payments would terminate after each participant received an amount pursuant to ss. 9 and 10 equal to the price paid by such participant for its participation certificate (P.A. s. 10).

12 Under s. 11 of the participation agreement, if C.C.B. failed by October 31, 1985 to obtain the shareholder and regulatory approval necessary for it to increase its authorized capital to the extent required for it to perform the equity agreement, as discussed below, then s. 10 of the participation agreement would be deemed to have been amended and would be construed as requiring C.C.B. to pay to the participants 100 per cent of C.C.B.'s pre-tax income. This obligation would continue until such time as the total amount received by each participant from the portfolio assets and C.C.B.'s pre-tax income satisfied the amount paid by that participant for its participation certificate, together with interest at prime rate. It should be noted that this was the only circumstance under which C.C.B. was to pay interest to the participants.

13 Section 8 of the participation agreement provided that C.C.B. indemnified each participant against any loss suffered by it by reason of the amounts realized from the portfolio assets and from 50 per cent of C.C.B.'s pre-tax income failing to equal the price paid by that participant for its participation certificate. This indemnity was to be paid only by payments of the amount and source described in ss. 10 and 11, with one important exception: "if CCB becomes insolvent or is

wound up, any amount remaining unpaid and required to be paid in order to indemnify that Participant completely in accordance with the foregoing indemnity, shall constitute indebtedness of CCB, to which the provisions of section 13 shall apply."

14 The relevant parts of s. 13 of the participation agreement read as follows:

> **13. Priorities on Insolvency**
>
> (*a*) *Notwithstanding the provisions of section 277 of the Bank Act* [which otherwise gives Canada and a province a first and second charge respectively on the assets of an insolvent bank] or any other rule of law, each of the Participants agrees that, in the case of the insolvency or winding-up of CCB:
>
>> (i) neither Canada, CDIC nor Alberta shall, in connection with any money owing to it under this agreement, claim any charge on the assets of CCB;
>>
>> (ii) *the right of each of the Participants other than CDIC* to money owing to it under this agreement *shall rank pari passu with the right of the depositors* of CCB to payment in full of the deposit liabilities of CCB;
>>
>> (iii) the right of CDIC to money owing to it by CCB, under this agreement but not by reason of the subrogation of CDIC to the claims of depositors of CCB (if any) shall be subordinate in right of payment to the prior payment in full of all money owing to the other Participants under this agreement and to the depositors of CCB, but shall rank in priority to any outstanding bank debentures of CCB.
>
> *Each of Canada, CDIC and Alberta acknowledges that it has waived, as set out above, any priority to which it would otherwise be entitled.* Each Participant agrees that this *section 13 is intended to benefit the depositors of CCB*, and to ensure to the benefit of the successors of CCB and any curator, liquidator or receiver that may be appointed to supervise or to wind up the business of CCB.

[Emphasis added.] Moreover, s. 13 provided that each participant would rank pari passu with each other except C.D.I.C. and that each would, as necessary, redistribute payments received by it in order to achieve this ranking.

15 Pursuant to s. 12 of the participation agreement, C.C.B. could not, without the consent of the participants, declare or pay any dividend or reduce its issued capital until such time as C.C.B. paid to each participant its purchase price, and any additional amount (interest at prime rate) payable under s. 11. Moreover, the participants required as a condition to their purchase, inter alia: (1) the execution of an amending and subordination agreement; (2) the execution of the equity agreement; and (3) the opinion of the Inspector General of Banks that C.C.B. would be solvent following the purchase (P.A. ss. 14 and 16). Finally, the parties expressly declared that the participants were not partners or joint venturers with each other (P.A. s. 18(j)) and that the law governing the agreement would be the law applicable in the province of Ontario (P.A. s. 18(d)).

16 The equity agreement (C.O.A. at pp. 154-74) gave the participants warrants providing for the right to subscribe to a total of 24,062,517 common shares of C.C.B. at a price of $0.25 per share, on a basis proportionate to each participant's participation interest (E.A. ss. 2, 3, 5 and 6). At the date of the agreement, C.C.B. had an authorized capital of 10,000,000 common shares with a par value of $10 each, of which 6,529,768 were issued and outstanding (E.A. s. 4). If all outstanding employee stock options to purchase common shares were exercised and all issued convertible preferred shares were converted into common shares, the issued capital of C.C.B. would consist of a total of 8,020,839 common shares (E.A. s. 4). Thus, if the warrants were fully exercised, the participants would own 75 per cent of C.C.B.'s common shares.

17 Shareholder and regulatory approval were required to increase C.C.B.'s authorized capital from its current level of 10,000,000 common shares to the 32,100,000 required in order to give full effect to the equity agreement. Pursuant to s. 15 thereof, C.C.B. had to first obtain shareholder approval no later than October 31, 1985, and next had to apply to the Minister of Finance pursuant to the *Bank Act*, R.S.C., 1985, c. B-1 (formerly S.C. 1980-81-82-83, c. 40), for the necessary

change in its authorized capital. If such an application was not made by October 31, 1985, the provisions of s. 11 of the participation agreement (100 per cent pre-tax income plus interest) were triggered. In s. 8 of the memorandum of intent, Canada had agreed that "an application for such alteration in capital when made shall be approved for purposes of the Bank Act."

18 The limited authorized capital of C.C.B. was not the only obstacle to the issuance of common shares to the participants. Under present law, the chartered banks which were participants could not legally exercise their right to subscribe to common shares of C.C.B. This was recognized by the parties in para. (d) of the preamble to the equity agreement as well as in s. 10 of the agreement. Under s. 8 of the equity agreement, the warrants were made fully assignable and it was the declared intention of the participants, as recorded in the preamble, "that unless the present law is materially changed, they shall assign such rights."

19 The participants' right to purchase these shares was to continue for a period of ten years after the date on which each participant had been repaid the full amount it had advanced under the terms of the participation agreement (E.A. ss. 1 and 12). Again, this agreement would be governed by and construed in accordance with the law applicable in the province of Ontario (E.A. s. 19).

20 Finally, under the amending and subordination agreement, the holders of all outstanding subordinated debentures issued by C.C.B. pursuant to s. 132 of the *Bank Act* (i.e., Canada, British Columbia, Alberta and the Workers' Compensation Board of British Columbia), agreed to postpone the repayment of the amounts represented by their debentures until such time as C.C.B. had paid to each participant an amount equal to the price paid by that participant for its participation certificate.

21 To summarize, the participants were to receive in return for the $255 million advanced under the support program, proportionally to their own financial contribution and up to that amount: (1) payments from the portfolio assets; (2)(a) 50 per cent of C.C.B.'s pre-tax income and warrants to buy up to 75 per cent of C.C.B.'s common shares, or (b) 100 per cent of C.C.B.'s pre-tax income, with interest on the amount contributed; and (3) an indemnity for any losses caused. Under these agreements, the participants could receive a return which was greater than their contribution only in two ways, namely, by exercising or assigning their warrants up to ten years after full repayment (however, this option was contingent on shareholder, regulatory and legislative approval) or, if these warrants could not be granted, by receiving interest on the amount advanced at the prime rate.

22 C.C.B. was advised by the Office of the Inspector General of Banks, by a letter dated April 24, 1985, as to the appropriate accounting treatment to be applied to these transactions. Following these guidelines, C.C.B. wrote down its loan assets by $255 million, charged the write-down to tax-allowable appropriations for contingencies and credited the $255 million received from the participants to tax-paid appropriations for contingencies. C.C.B. was not specifically directed by the Inspector General of Banks to record its indemnity towards the participants as a liability, nor did C.C.B. do so. By effectively "selling" that portion of its loan portfolio not likely to be recovered and by not recording its indemnity obligation under the participation agreement to repay the $255 million as a liability, C.C.B. was able to restore a position of solvency on its books, thereby allowing it to remain in business, which was, after all, the raison d'être of the support program.

23 Despite this financial assistance, C.C.B.'s financial status con tinued to deteriorate. For reasons beyond the scope of this appeal, the support program was unsuccessful in ensuring C.C.B.'s long-term solvency. By an order made September 3, 1985 on a petition by C.D.I.C., Wachowich J. of the Alberta Court of Queen's Bench ordered C.C.B. to be wound up pursuant to the *Winding-up Act*, R.S.C. 1970, c. W-10. At that point, none of the participants had exercised or assigned (or even been granted) any of their warrants under the equity agreement as the preliminary conditions of shareholder and regulatory approval, for the authorization and issuance of additional common shares had not been fulfilled. Price Waterhouse Limited was appointed, and remains, the sole liquidator of C.C.B. ("liquidator").

24 As of August 18, 1987 the liquidator had recovered approximately $112 million on account from C.C.B.'s portfolio assets, of which $5 million was attributable to the portion thereof beneficially owned by the participants (namely, the syndicated portion). The liquidator brought an application before Wachowich J. for advice and direction as to the interpretation of the support agreements. In particular, the liquidator sought to determine the validity and ranking of the claims of the participants pursuant to the participation agreement.

25 In a judgment rendered on December 7, 1987 Wachowich J. held the participants to be entitled to the repayment of sums recovered by the liquidator on the syndicated portion of the portfolio assets (the $5 million), but otherwise not entitled to recover their advances until after all ordinary creditors, including unsecured creditors, were paid in full. Wachowich J. interpreted the injection of funds by the participants to have been a capital investment. The participants, apart from Canada and C.D.I.C., the respondents in this appeal, successfully appealed the latter part of this judgment. The Alberta Court of Appeal disagreed with Wachowich J., preferring to characterize the advance of $255 million as a loan. The Court of Appeal concluded that the participants were entitled to rank pari passu with C.C.B.'s unsecured creditors for all moneys advanced to C.C.B. pursuant to the participation agreement and not repaid by moneys recovered from the syndicated portion of the portfolio assets.

26 On an application by the liquidator, Wachowich J. directed the liquidator to present an application to this court for leave to appeal from the Court of Appeal's decision. Wachowich J. further ordered that Lerner & Associates be appointed as legal representative ("legal representative") of C.C.B.'s general body of creditors, other than the participants, for purposes of the application for leave to appeal and further on the appeal. Leave to appeal to this court was granted on March 14, 1991. The liquidator, as an officer of the court and as the representative of all the creditors of C.C.B., takes no position in this appeal. The bank group and Alberta, the respondents before this court, made separate written and oral submissions.

II. Judgments in the Courts Below

A. Alberta Court of Queen's Bench

27 On the initial application, the participants took the position that they were entitled under the terms of the support agreements: (1) to receive their proportionate shares of the moneys received by the liquidator or C.C.B. on account of the portfolio assets; and (2) to rank pari passu with all the other unsecured creditors of C.C.B. for any amounts not recovered from the portfolio assets and still owing to them pursuant to the participation agreement. Wachowich J. agreed with the first proposition but rejected the second.

28 According to Wachowich J., the participants' first submission involved a consideration of the validity of the participation agreement. The learned chambers judge confessed it was a "difficult task" to determine the position of the participants with respect to C.C.B.'s estate given the "extraordinary nature of the agreement" involved (at p. 126) [A.R.]. He noted there were no precedents dealing with similar commercial agreements. In his view, the participation agreement in question was not prohibited by ss. 173 and 174 of the *Bank Act*. While the agreement did not relate to business in which a bank would normally or commonly engage, he noted that "given the unique circumstances and the stated purpose of the Participation Agreement as a whole, one can hardly regard this as an invalid transaction" (at p. 127). He found it was a valid contractual document binding on all parties and held that the participants were entitled to receive their proportionate share from moneys recovered by the liquidator from the portfolio assets, in the manner provided for in s. 9 of the participation agreement (i.e., to the extent such recoveries exceed the C.C.B. portion).

29 Next, Wachowich J. turned to a consideration of the ranking of the participants with the general body of creditors of C.C.B. for any amounts not recovered from the syndicated portion of the portfolio assets, and still owing pursuant to the participation agreement. He noted that the participants would have "valid claims" under the terms of the participation agreement for such amounts (at p. 128). However, whether they could rank pari passu with other unsecured creditors

depended on the interpretation of the agreement taken as a whole and a determination of the "real basis upon which the $255 million was paid to C.C.B." (at p. 128).

30 In Wachowich J.'s view, the essence of the participation agreement was not the creation of a mere purchase and sale of assets with an added indemnity as to the value of those assets. Rather, the transaction reflected an investment of capital into C.C.B. (at p. 129):

> The agreement, as evidenced by all the surrounding circumstances, was really to effect an infusion of capital into C.C.B. whereby the Participants would be risking their monies in hope that the C.C.B. would continue as a viable and profitable business. If this in fact had occurred, the Support Group Participants stood to gain a healthy return on their investments.

31 The learned chambers judge found support for his characterization in the following: (1) the portion of the portfolio assets purchased by the participants was of little value; (2) s. 2 of the participation agreement masked the true nature of the transaction, that is, the investment of working capital into C.C.B.; (3) the indemnity provision and repayment structure set up by the agreement were directly connected to the profits and income of C.C.B.; (4) the repayment of the purchase price was to come not only from the portfolio assets, but mainly from C.C.B.'s pre-tax income; (5) if C.C.B.'s business was successful, the participants would benefit not only in recovering their purchase price, but as well by purchasing common shares in C.C.B. under the equity agreement; (6) "[w]hile the transaction may not be a typical investment situation, where for example there is an outright purchase of shares, it is difficult to ignore the investment features of the agreement" (at p. 130); (7) while the accounting treatment had to be looked at with caution, the fact there was no liability to the participants recorded on the balance sheet of C.C.B., as created by the indemnity provisions of the agreement, supported the conclusion that the transaction was an investment; (8) the cases of *Laronge Realty Ltd. v. Golconda Investments Ltd.* (1986), 7 B.C.L.R. (2d) 90, 63 C.B.R. (N.S.) 76 (C.A.) ("*Laronge Realty*"); *Re Dickie* (1924), 5 C.B.R. 214 (N.S.T.D.); and *Re Meade*, [1951] 1 Ch. D. 774, [1951] 2 All E.R. 168, "stand for the general proposition that advances of monies will be classed as capital investments where the monies were used in the business and the business was carried on for the joint benefit of the parties involved" (at p. 131); and (9) the participants here did have a stake in the continued profitability of C.C.B. in that (a) the repayment of the money advanced would come from the income of C.C.B. and (b) their warrants allowed them to "continue to share in the profits of C.C.B." (at p. 131).

32 Thus, according to Wachowich J., the participants could not rank pari passu with the ordinary creditors of C.C.B., including unsecured creditors, for the amounts not recovered from the portfolio assets. In so doing, he applied the principle that "if a person contributes capital to a business, even though that person is not a partner in the business and may have received no share of the profits, they cannot prove their claim in bankruptcy in competition with the creditors of the business" (at p. 131): Halsbury's Laws of England (3rd ed.), vol. 2, at p. 495; *Laronge Realty*, supra; and *Re Beale; Ex parte Corbridge* (1876), 4 Ch. D. 246.

33 In concluding, Wachowich J. held the provisions of the participation agreement which attempt to rank the participants pari passu and to create a debt on insolvency are ineffective to alter the "existing legal nature of their relationship" with C.C.B. These provisions would be void as they are an attempt to alter insolvency laws through a private agreement: *British Eagle International Airlines Ltd. v. Compagnie Nationale Air France*, [1975] 1 W.L.R. 758, [1975] 2 All E.R. 390 (H.L.).

B. Alberta Court of Appeal

34 The respondents (the participants apart from Canada and C.D.I.C.) appealed from Wachowich J.'s conclusion with respect to their ranking on insolvency, whereas the then legal representative cross-appealed from the conclusion that the participants could receive funds from the syndicated portion of the portfolio assets. Harradence J.A. (writing for the Court of Appeal) began by stating that the learned chambers judge had erred in law in his interpretation of the decisions in *Laronge Realty*, supra, *Re Dickie*, supra, and *Re Meade*, supra (at p. 207) [A.R.]:

> I have examined closely the cases relied upon as well as others to which I have been referred and the inescapable conclusion to be reached is that the proposition as stated [by Wachowich J.] can only be correct where one implies into the term 'monies were used in the business' a necessary condition that the investor has not expressly stipulated a requirement for the repayment of monies advanced. A failure to imply this term into the proposition results in a misstatement of the appropriate test and, further, is inconsistent with the decision of the Supreme Court of Canada in *Sukloff v. Rushforth* (1964), 45 D.L.R. (2d) 510 (S.C.C.).

35 Harradence J.A. reviewed the cases cited by Wachowich J. and noted that, unlike the case at bar, none of them involved transactions where provisions for the repayment of the money advanced had been included by the parties. Turning specifically to *Sukloff v. A.H. Rushforth & Co.*, [1964] S.C.R. 459, 6 C.B.R. (N.S.) 175, 45 D.L.R. (2d) 510 ("*Sukloff v. Rushforth*"), Harradence J.A. said that while it was "difficult to glean" from that case the exact reason for concluding that the transaction under consideration therein was a loan rather than a capital investment, "the only reasonable conclusion to be reached is that the provision for repayment was determinative of the nature of the transaction" (at p. 209). He concluded his review of the jurisprudence by stating (at p. 210): "where, as in this case, the evidence indicated that monies advanced to a business are to be repaid, and particularly when the terms of repayment are specified, the transaction is classified as a loan."

36 Harradence J.A. next turned to the interpretation of the participation agreement. He noted at the outset the rule prohibiting extrinsic evidence from contradicting express contractual terms. He reviewed a number of factors favouring interpreting the agreement as a loan, namely: (1) there is nothing in the express terms of the agreement which supports a conclusion that the money was advanced as an investment; (2) there are express provisions pointing to the opposite conclusion, including provisions for repayment and for an indemnity that full repayment will be made; (3) pursuant to the participation agreement, upon insolvency or winding-up, any amount remaining unpaid was to constitute indebtedness and, in such circumstances, the participants were to rank pari passu with other creditors; and (4) the intention of the participants was consistent with a "loan" characterization. He did not find it necessary to determine whether the accounting treatment was consistent with an investment, holding that such a factor is not determinative of the legal relationship of the parties.

37 Harradence J.A. found that repayment of the money advanced was intended and was coupled with express repayment provisions. Thus, relying on *Sukloff v. Rushforth*, supra, and the other cases cited, he concluded that the $255 million advanced was not to be characterized as an investment in capital but rather as a "loan coupled with a purchase agreement to C.C.B." (at p. 211).

38 The observation made by the learned chambers judge that the business of C.C.B. was carried on for the "joint benefit" of C.C.B. and the participants, because (1) repayment was to come from the income of C.C.B. and (2) the warrants, if exercised, would allow the participants to continue to share in the profits of C.C.B., was next addressed. With respect to the first factor, Harradence J.A. held that Wachowich J. erred in considering the *source of the funds for* repayment in concluding that the participants would be sharing in C.C.B.'s profits. His comments warrant citation (at p. 211):

> It is important to recognize that while repayment was to be made from pre-tax income of C.C.B., there was no direct link between the success of the C.C.B. and the overall quantum of the amount due to or payable to the Support Group Participants. I have been referred to no authority which supports the proposition that a repayment, the instalments of which are referable to the quantum of the income of the debtor, is a situation of 'joint benefit'. Since the sums to be received by the Participants were limited to repayment of monies advanced, with a contingent right to interest, the source of the repayment monies is not relevant and, with respect, the learned Chambers Judge erred in concluding the Participants were 'sharing in profits' in this respect.

39 As for the second factor, Harradence J.A. summarily rejected it as an indicium of investment and "joint benefit" mainly because of the *contingent nature* of the warrants in question, as recognized by both the participation agreement and the equity agreement. He added (at p. 212): "Had shares actually been issued or even approval obtained, or if there

was an obligation to purchase or if a purchase had been made, then the 'joint benefit' argument might have some merit and it would have been necessary to fully address this issue."

40 Finally, Harradence J.A. considered whether repayment to the respondents was nevertheless postponed pursuant to what are now s. 139 of the *Bankruptcy Act*, R.S.C. 1985, c. B-3, and s. 4 of the *Partnerships Act*, R.S.O. 1990, c. P.5. In his view, the application of these provisions was precluded by his earlier conclusion that the participants were not to receive a rate of interest varying with the profits of C.C.B. or a share in the profits of C.C.B.

41 Thus, the appeal was allowed and it was ordered that the respondents were entitled to rank pari passu with the ordinary creditors of C.C.B. for all moneys advanced to C.C.B. pursuant to the participation agreement and not repaid by moneys recovered from the portfolio assets. In view of this result, the cross-appeal brought by the then legal representative, alleging an inconsistency in Wachowich J.'s conclusions, was dismissed.

III. Issues

42 There are many ways of characterizing the issues raised by this appeal. As I see it, the three main questions which need to be addressed are:

> (1) Was the Court of Appeal correct in characterizing the advance of $255 million by the participants to the C.C.B. as a loan, as opposed to an investment in capital, thereby creating a debtor-creditor relationship between the parties?
>
> (2) If the true legal nature of this transaction is indeed a loan, does this loan come within the postponement provision found in s. 4 of the *Partnerships Act*?
>
> (3) If the *Partnerships Act* does not apply, should the respondents' claim for the money loaned under the participation agreement nonetheless be postponed to the claims of the general body of C.C.B. unsecured creditors, other than the participants, based on the United States doctrine of equitable subordination?

The legal representative raises a subsidiary issue concerning the portion of the moneys recovered attributable to the syndicated portion of the portfolio assets:

> (4) Was the Court of Appeal correct in upholding the conclusion of the learned chambers judge that the participants are entitled to receive from the liquidator, pursuant to the participation agreement, the sums recovered on the syndicated portion of the portfolio assets?

43 For the reasons that follow, it is my view that the first and fourth questions should be answered in the affirmative while the second and third should be answered in the negative. In summary, the words chosen by the parties in their agreements clearly support the Court of Appeal's conclusion that the assistance program involved, in substance, a loan of $255 million and not a capital investment. The surrounding circumstances provide additional support for, rather than detract from, this conclusion. Although the transaction did have an equity component (the warrants), this aspect alone does not, in the circumstances of this case, transform the essential nature of the advance from a loan to an investment. Put another way, while it is true that this transaction does have "investment features," these features were incidental to the debt features of the arrangement and do not alter the substance of the debtor-creditor relationship that was created by the parties with respect to the $255 million advanced by the participants to C.C.B. Moreover, the fact that C.C.B.'s pre-tax income was the main source for repayment does not affect this characterization as the amount to be repaid from this source was limited to the sum advanced to C.C.B., plus a contingent interest at prime rate. Thus, the respondents are creditors of C.C.B. and, as such, are entitled to what may be called a "prima facie" pari passu ranking with the other unsecured creditors of C.C.B. in the distribution of C.C.B.'s assets.

44 In the circumstances of this case, this prima facie ranking is not altered by the principles of law and equity relied upon by the legal representative. Indeed, the loan in question does not fall within the ambit of the Ontario *Partnerships Act* (ss. 3(3)(*d*), 4) as the participants were to receive neither a "rate of interest varying with the profits" of C.C.B. nor a

"share of the profits arising from carrying on the business" of C.C.B. In my view, the principles of equitable subordination have no application to the facts of this case. Finally, in light of these conclusions, the legal representative's subsidiary issue concerning the moneys recovered on the syndicated portion of the portfolio assets must also fail. Accordingly, I would dismiss the appeal.

IV. Relevant Statutory Provisions

Winding-up Act:

45

Distribution of Assets

93. The property of the company shall be applied in satisfaction of its debts and liabilities, and the charges, costs and expenses incurred in winding-up its affairs.

94. All costs, charges and expenses properly incurred in the winding-up of a company, including the remuneration of the liquidator, are payable out of the assets of the company, in priority to all other claims.

95. The court shall distribute among the persons entitled thereto any surplus that remains after the satisfaction of the debts and liabilities of the company and the winding-up charges, costs and expenses, and unless otherwise provided by law or by the Act, charter or instrument of incorporation of the company, any property or assets remaining after the satisfaction shall be distributed among the members or shareholders according to their rights and interests in the company.

Partnerships Act:

46

3. In determining whether a partnership does or does not exist, regard shall be had to the following rules:

. . . . .

3. The receipt by a person of a share of the profits of a business is proof, in the absence of evidence to the contrary, that the person is a partner in the business, but the receipt of such a share or payment, contingent on or varying with the profits of a business, does not of itself make him or her a partner in the business, and in particular,

(*a*) the receipt by a person of a debt or other liquidated amount by instalments or otherwise out of the accruing profits of a business does not of itself make him or her a partner in the business or liable as such;

. . . . .

(*d*) the advance of money by way of loan to a person engaged or about to engage in a business on a contract with that person that the lender is to receive a rate of interest varying with the profits, or is to receive a share of the profits arising from carrying on the business, does not of itself make the lender a partner with the person or persons carrying on the business or liable as such, provided that the contract is in writing and signed by or on behalf of all parties thereto;

. . . . .

4. In the event of a person to whom money has been advanced by way of loan upon such a contract as is mentioned in section 3, or of a buyer of the goodwill in consideration of a share of the profits of the business, becoming insolvent or entering into an arrangement to pay his or her creditors less than 100 cents on the dollar or dying in insolvent circumstances, the lender of the loan is not entitled to recover anything in respect of the loan, and the seller of the

goodwill is not entitled to recover anything in respect of the share of profits contracted for, until the claims of the other creditors of the borrower or buyer, for valuable consideration in money or money's worth, are satisfied.

V. Analysis

A. Characterization of the $255 million advanced: capital investment or loan?

47 The first and foremost issue in this appeal concerns the determination of the true nature of the transaction in question between the participants and C.C.B. Was the $255 million advanced by the participants in the nature of a loan, as found by the Court of Appeal, or in the nature of an investment of capital, as found by the learned chambers judge? If the Court of Appeal was correct in describing the transaction as a loan, it follows that the participants are creditors of C.C.B. and as such, pursuant to both the participation agreement and ss. 93 to 95 of the *Winding-up Act*, they would be entitled, subject to the statutory (s. 4 of the *Partnerships Act*) and equity ("equitable subordination") principles raised by the legal representative, to rank pari passu with the other ordinary creditors of C.C.B. in the distribu tion of C.C.B.'s assets. If, however, Wachowich J.'s characterization is to be preferred, then, relying on an old common law principle, it is argued the participants would not be creditors entitled to an equal ranking with C.C.B.'s true creditors: *Re Beale*, supra; *Re Meade*, supra; *Laronge Realty*, supra; and Halsbury's Laws of England (4th ed.), vol. 3(2), at p. 315. Under this approach, it is said the participants would have an equitable right to share in the distribution of the assets of C.C.B., but only at such time as the ordinary creditors have been paid in full.

48 The principal argument raised by the legal representative in favour of finding the transaction to have been that of a capital infusion is the potential for unlimited returns and control over C.C.B. by reason of the warrants granted to the participants under the equity agreement. Other indicia of capital investment are also suggested. First, C.C.B.'s accounts did not show their obligation to the participants as a liability. It is submitted that, if the financial statements could have led creditors, including depositors, to believe that there was adequate capitalization, this should be taken into consideration in determining the rights of the ordinary creditors and the respondents. Second, it is argued that the Court of Appeal's interpretation of ss. 8 and 13 of the participation agreement fails to recognize that the rights of differing classes of people who provide funds for the use of a business crystallize prior to insolvency, and cannot be altered by an agreement. It is argued that the Court of Appeal erred in assuming that the characterization by the participants and C.C.B. of their rights and obligations inter se should be determinative of the relative priority of the claims of the participants and the ordinary creditors of C.C.B. According to the legal representative, "Section 13 should be disregarded by the Courts, as being a self-serving attempt by the Participants to enhance their position for distribution purposes in the event of insolvency." Finally, the legal representative argues that the Court of Appeal erred in its interpretation of *Sukloff v. Rushforth*, supra, which, according to him, stands for proposition that, if someone has an interest in a business, in the sense that his or her potential for return is unlimited except by the enterprise's actual ability to generate profits, that person may not rank as a creditor if the business becomes insolvent. The key, according to the legal representative, is the right or potential to an unlimited return, not the right to repayment.

49 The respondent Alberta, on the other hand, submits that the advance was a loan and offers the following arguments: (1) the agreement for the advance contained no express provision that the advance was an investment in capital but did contain express provisions to the contrary, including provisions for repayment and an indemnity for that repayment; (2) the parties intended the advance to be repayable; (3) C.C.B. was contingently liable to pay interest; (4) in its financial state ments C.C.B. accounted for the advance as being a debt by disclosing the outstanding balance of the advance at the opening, repayments during, and the obligation for the outstanding balance at the closing of each reporting period; (5) Mr. Justice Estey considered the advance to be a loan in the *Report of the Inquiry into the Collapse of the CCB and Northland Bank* (1986) ("Estey report"), at pp. 115, 118 and 125; (6) the participants could not and did not invest in C.C.B.'s equity capital; (7) the decision of this court in *Sukloff v. Rushforth*, supra, as correctly demonstrated by the Court of Appeal, supports the conclusion that the advance to C.C.B. was a loan; and (8) according to *Sukloff v. Rushforth*, supra, and other decisions, an advance of money which is to be repaid, without more, is a loan and not an investment in equity capital or the supply of capital for the business of the recipient for the joint benefit of the advancer of money and the recipient, even if it is described as an investment of capital or if the person advancing the money is to share the profits

or to receive shares of the recipient or if the advance is repayable when funds are available or out of profits. Alberta also takes issue with the legal representative's characterization of s. 13 of the participation agreement. It submits that this is a common provision in loans and, rather than enhance the participants' ranking on insolvency, has the effect of reducing the otherwise priority ranking of Canada, Alberta and C.D.I.C.

50 For their part, the bank group notes that the agreements in question represent a unique response to a unique situation, and thus, cannot be perceived as a normal investment in a business. For the reasons given therein, they commend the Court of Appeal's characterization of the advances as a loan in the form of a purchase of doubtful assets. Specifically, they submit that Harradence J.A. was correct in finding that, because of the contingent nature of the warrants, the support agreements did not provide a right to share in profits or for a rate of interest that varied with profits. They characterize the equity agreement as a mere "sweetener." The bank group submits that the cases, including *Sukloff v. Rushforth*, supra, do not support the conclusion that a contingent right to profits in circumstances like the case at bar can represent an interest in the business. With respect to the accounting issue, they argue that they should be considered on a basis different from the other participants because they were prohibited from controlling or attempting to control C.C.B. Indeed, they had no control over how C.C.B. showed its obligations to them in its financial statements. Further, such a factor should not determine the nature of the legal relationship between the parties to the agreement.

51 For my part, I agree in essence with the position advanced by Alberta and the bank group. Briefly put, the words chosen by the parties in their agreements strongly support the Court of Appeal's conclusion that the financial assistance program involved, in sub stance, a loan of $255 million rather than a capital investment and there is nothing in the surrounding circumstances which distracts from this characterization. On the contrary, the surrounding circumstances offer additional support for the Court of Appeal's conclusion. As noted by Wachowich J. and the legal representative, the transaction did indeed have an equity component (the warrants) and did involve a repayment scheme linked to the profits of C.C.B. However, for reasons which I shall elaborate, these aspects are insufficient to justify the conclusion reached by Wachowich J.Similarly, the other indicia of capital investment put forward by the legal representative, such as the accounting treatment given to the advance, do not affect the substance of this transaction.

52 As in any case involving contractual interpretation, the characterization issue facing this court must be decided by determining the intention of the parties to the support agreements. This task, perplexing as it sometimes proves to be, depends primarily on the meaning of the words chosen by the parties to reflect their intention. When the words alone are insufficient to reach a conclusion as to the true nature of the agreement, or when outside support for a particular characterization is required a consideration of admissible surrounding circumstances may be appropriate.

53 In the case at bar, it should be noted that the circumstances surrounding the financial arrangements between C.C.B. and the participants, and the agreements themselves, are somewhat unique. At the heart of this matter is the attempted rescue of a Canadian chartered bank. Recourse to emergency measures in order to preserve the solvency of a bank is, fortunately, relatively rare in our country. I say this not because financial support programs are harmful (quite the contrary), but because the events surrounding the C.C.B. rescue in the mid-1980s infrequently arise. Part of the result, however, is that the task of ascertaining the intention of the participants and of C.C.B. with respect to the advance of $255 million is not particularly simple. Indeed, the learned chambers judge described the participation agreement as a "unique document based on a unique set of facts" as well as an "extraordinary transaction," and he found it "most difficult" to characterize (at pp. 132 and 126). Similarly, Harradence J.A. said that "The unique situation of C.C.B. and the Participants resulted in novel and complex documentation, the interpretation and characterization of which is a challenging and difficult task" (at p. 206).

54 It is evident from reviewing the agreements in question that characteristics associated with both debt and equity financing are present. The most obvious examples are, on the one hand, ss. 8 and 13 of the participation agreement pertaining to C.C.B.'s indemnity towards the participants and their ranking in the event of a winding-up and, on the other hand, the provisions of the equity agreement con cerning the warrants granted by C.C.B. to the participants. Such a duality is apparently quite common in loan participation agreements. Indeed, in an article entitled "Characterization of Loan Participation Agreements" (1988), 14 Can. Bus. L.J. 336, Professor Ziegel uses the heterogeneity in some loan

participations to explain, in part, the divergence of judicial and academic opinion in the United States on the proper characterization of a participation agreement (at p. 337):

> This issue [the characterization of the participation agreement] has provoked a large body of case law and textbook and periodical literature, most of it American, and the conclusions are not always the same. At one time or another one or more of the following descriptions have been applied to a participation agreement: a simple debtor-creditor relationship, with or without the benefit of security; an agency agreement; a partnership or joint venture; a trust; and, finally, a sale or assignment of an undivided interest in the loan.
>
> It is easy to see why there should be this divergence of opinion. As with any agreement, the parties are free to verbalize it as they see fit and ambiguous or neutral language may reflect their unwillingness to answer hard questions, perhaps in the hope that the need to do so may never arise. Frequently, the several parts of a participation agreement lend themselves to different characterizations and the agreement is really a composite of cumulative legal elements. Finally, there is a significant overlap between such flexible concepts as a secured loan or trust and the sale or assignment of an undivided share of a loan, and the language of the agreement may be consistent with more than one of them. Faced with such ambiguity, the job of the adjudicator, when a dispute arises, is to find the characterization that best seems to fit the parties' intentions as derived from the total agreement and all the surrounding circumstances.

55 As I see it, the fact that the transaction contains both debt and equity features does not, in itself, pose an insurmountable obstacle to characterizing the advance of $255 million. Instead of trying to pigeonhole the entire agreement between the participants and C.C.B. in one of two categories, I see nothing wrong in recognizing the arrangement for what it is, namely, one of a hybrid nature, combining elements of both debt and equity but which, in substance, reflects a debtor-creditor relationship. Financial and capital markets have been most creative in the variety of investments and securities that have been fashioned to meet the needs and interests of those who participate in those markets. It is not because an agreement has certain equity features that a court must either ignore these features as if they did not exist or characterize the transaction on the whole as an investment. There is an alternative. It is permissible, and often required, or desirable, for debt and equity to co-exist in a given financial transaction without altering the substance of the agreement. Furthermore, it does not follow that each and every aspect of such an agreement must be given the exact same weight when addressing a characterization issue. Again, it is not because there are equity features that it is necessarily an investment in capital. This is particularly true when, as here, the equity features are nothing more than supplementary to and not definitive of the essence of the transaction. When a court is searching for the *substance* of a particular transaction, it should not too easily be distracted by aspects which are, in reality, only incidental or secondary in nature to the main thrust of the agreement.

56 The weight to be given to one aspect of the support agreements over another in assessing the true intention of the parties underlies the difference in opinion between the learned chambers judge and the Court of Appeal's characterization of the transaction. Wachowich J. emphasized both the fact that the recovery by the participants of their contribution was dependent upon the income generated by C.C.B. and the participants' potential to share in the future success of C.C.B. by the warrants, even after having been repaid, as evidencing that the essence of the transaction was that of a capital investment. The Court of Appeal, however, largely dismissed the relevance of the equity agreement because of its contingent nature and emphasized instead that the participants were only entitled to receive from C.C.B. the amount advanced to it and that the parties had included specific provisions in the participation agreement referring to debt; all of which amounted to a very strong indicium of a loan.

57 In the circumstances of this case, it is my view that the learned chambers judge and the legal representative give far too much weight to the equity features associated with the equity agreement in characterizing the overall nature of the advance of $255 million. It is true the participants received warrants to purchase common shares of C.C.B. through the equity agreement. It is also true, at least in theory, that by fully exercising their warrants the participants would own 75 per cent of the common shares issued by C.C.B. However, it is evident on the face of the record that this possibility was not only a mere hypothesis, but it was unlikely to occur. As noted by the respondents and the Court of Appeal, shareholder

and regulatory approval was required to permit an increase in C.C.B.'s authorized capital and, unless the warrants were assigned, an amendment to the *Bank Act* was necessary before the participants who are chartered banks could fully exercise their rights to purchase shares. It is not without significance that none of the participants ever exercised any of their warrants nor did they assign them. In these circumstances, I agree with the Court of Appeal that the true effectiveness of the equity agreement was highly contingent and that the learned chambers judge erred in not considering the warrants for what they really were, namely, so-called "sweeteners" or "kickers" with respect to the advance of $255 million which were simply additional features to the underlying loan arrangement between the parties. Undoubtedly, the warrants are an equity feature of the transaction supporting a conclusion that the advance was an investment. However, in the facts of this case, only minimal weight should be given to this factor in the overall characterization of the agreement. Alone, the highly contingent warrants are surely insufficient to tip the scales when faced with the strong indicia of debt present here as identified by the Court of Appeal.

58 Wachowich J. also erred in concluding that the participants would be "sharing in the profits" of C.C.B. under the support agreements. The participation agreement simply *referred to* C.C.B.'s profits (i.e., pre-tax income) as one of the *sources* for repayment. The other source for repayment, the moneys recovered on the syndicated portion of the portfolio assets, was not linked with C.C.B.'s profits. While full repayment from the portfolio assets alone was unlikely, the fact remains that the amount of money to be paid to the participants from both sources was fixed at the amount advanced by each for their participation certificate. Regardless of where the repayments were coming from, they remained mere repayments for moneys advanced. Of course, the participants would benefit from the success of C.C.B.'s business; however, this benefit would be capped by the amount of the advance. I shall examine in greater detail the "sharing in profits" argument of the legal representative when I deal with s. 4 of the *Partnerships Act*. For now, it is sufficient to state that, in the circumstances of this case, the source from which C.C.B. was to repay the advance made does not carry any weight in favour of a finding that said advance was an investment in capital rather than what it appears to be on the face of the agreements, namely, a loan of $255 million coupled with an equity "sweetener" or "kicker."

59 Another error committed by the learned chambers judge relates to his reliance on the decisions of *Laronge Realty*, supra, and *Re Meade*, supra. The latter case together with *Re Beale*, supra, are said to have established the common law principle applied in *Laronge Realty* and upon which Wachowich J. relied in order to deny ranking the participants pari passu with C.C.B.'s unsecured creditors other than the participants. This principle is stated as follows in Halsbury's Laws of England (4th ed.), vol. 3(2) (at p. 315):

> If a person advances money to another, not by way of loan but as a contribution to the capital of a business carried on for their joint benefit, the person who has made the advance, even though he is not a partner in the business and has received no share of the profits as such, is debarred from proving in the bankruptcy of the recipient of the money in competition with the creditors of the business.

Briefly, I agree with Harradence J.A.'s conclusion that none of the agreements at issue in the cases relied upon by Wachowich J. contained express provisions for the repayment of the money advanced and that such a factor was crucial to the conclusions reached therein. I also agree that the express repayment scheme set out in the participation agreement clearly distinguishes the case at bar from those in which the common law rule relied upon by Wachowich J. has been applied.

60 This rule was referred to, but *not* applied, by this court in *Sukloff v. Rushforth*, supra, a case upon which the legal representative strongly relies. There, Ritchie J. declined to apply the common law rule since he found that the money advanced by Mr. Sukloff was more in the nature of a loan, thereby creating a debtor-creditor relationship between the parties. Indeed, just after citing the above excerpt, Ritchie J. stated (at p. 467): "As I have indicated, I do not construe Mr. Sukloff's role as that of one who was supplying capital for a business carried on for the joint benefit of himself and the two limited companies." Earlier, he had specifically agreed with the trial judge's finding that Mr. Sukloff's relationship with the companies in question "was confined to that of a *lender or financier* who had a right to share in the profits, if any, of the undertakings of these companies" (at pp. 465-66) (emphasis added). This "share in the profits" aspect was later used by Ritchie J. in order to postpone part of the money advanced by Mr. Sukloff (the unsecured $10,000 upon

which the legal representative asks this court to focus on) under what was then s. 98 (now s. 139) of the *Bankruptcy Act*, a provision similar to s. 4 of the *Partnerships Act*. However, this aspect had no effect whatsoever on the characterization of the true nature of the transaction involved and on the application of the common law rule set out in *Re Beale*, supra, and *Re Meade*, supra, and applied in *Laronge Realty*, supra. As found on the evidence, the advances in *Sukloff v. Rushforth*, supra, amounted to a loan.

61 As observed by Harradence J.A. in the case at bar, it is somewhat difficult to discern what specific evidence Ritchie J. was referring to when he agreed with the finding of the trial judge in *Sukloff v. Rushforth*, supra. However, I would note, as did Harradence J.A., that the agreements involved therein contained express repayment provisions similar to those contained in the participation agreement. It is not unreasonable to suggest that these provisions played an important role in the characterization of the advances as a loan. In any event, what is most important for our purposes is the fact that *none* of the moneys advanced by Mr. Sukloff was "postponed" under the common law principle advanced by Wachowich J. and the legal representative. The only part which was indeed postponed (the $10,000), was done so under the *Bankruptcy Act* and not following *Re Meade*, supra. I will explain in the context of my analysis of s. 4 of the *Partnerships Act* why, contrary to *Sukloff v. Rushforth*, supra, such statutory postponement has no application to the facts of this case (namely, because there is no profit sharing in the case at bar, simply a repayment out of profits). Suffice it here to say that, contrary to the legal representative's submissions, *Sukloff v. Rushforth* has no bearing on the characterization issue facing this court.

62 Similarly, contrary to the legal representative's submissions, the accounting treatment is not by itself of great weight in the characterization of the advance. I agree with the learned chambers judge that this "evidence" should be "looked at with caution" (at p. 130). I say this for the following interrelated reasons. First, C.C.B. was following the express directives given by the Office of the Inspector General of Banks, who is not a party to any of the agreements, in using the accounting methods it did. Second, as noted by the bank group, the accounting methods used by C.C.B. were beyond the control of many of the participants. Third, the legal representative is really asking us to look at the conduct of one party, after an arrangement has been signed, in order to discern the common intention of all contracting parties at the time of signing. This type of unilateral and after the fact "evidence" is clearly of little relevance and reliability with respect to the issues before this court. Fourth, as previously noted, the accounting treatment used and the success of the support program were closely linked and it is unwise to draw inferences on the legal relationship of the parties therefrom. For all these reasons, I would not place much weight on the accounting treatment used by C.C.B. in determining the true nature of the advance of $255 million. In so concluding, I do not wish to say that there may not be other cases where the accounting treatment *could* be helpful in determining the nature of a given transaction.

63 Finally, I cannot agree with Wachowich J. about the relevance to the characterization issue of the fact that the portion of the portfolio assets purchased by the participants was of little value. Even assuming that courts are entitled to weigh the value of the consideration given for a particular promise when characterizing an agreement, there was more to the support agreements than the mere purchase of participations in bad loans. Regardless of the true value of the syndicated portion, the participants were to be *repaid* the entire $255 million they had advanced to purchase their participation certificates. The source of this repayment was also the profits of C.C.B. and the parties agreed that any amount remaining unpaid upon insolvency would be considered an indebtedness by C.C.B. towards the participants.

64 On the other hand, the factors noted by the Court of Appeal of Alberta and the respondents as providing indicia of the "loan" nature of the advance of $255 million are clearly relevant to the characterization issue and they strongly support such a conclusion. I have already referred to these factors in summarizing the reasons of Harradence J.A. and the submissions made by Alberta and the bank group. To repeat the most important ones: (1) there is nothing in the express terms of the agreements which supports a conclusion that the money was advanced as an investment; and (2) there are express provisions supporting a characterization of the advance as a loan, including provisions for repayment (P.A. ss. 9-11), for an indemnity should full repayment not be made from the sources contemplated (P.A. s. 8), and for equal ranking with the ordinary creditors of C.C.B. (P.A. s. 13).

65 It is interesting to note that my conclusion that the $255 million advance was a loan also accords with the views of Mr. Justice Estey in his report. The relevant passages are found at pp. 115, 118 and 125 of the Estey report:

> The $255M reduced the bank's debt to the Bank of Canada, but itself became an obligation to be retired by collections on the Support Package loans or on liquidation, out of the assets of the bankrupt bank. The receipt of the $255M therefore is irrelevant to the presence or absence of solvency. Whatever state the bank was in at that time remained unaffected by the receipt of the Support Package moneys. The Inspector General, therefore, was in error in finding the bank to be solvent upon receipt of the $255M. It should be borne in mind that the $255M, by the terms of the interim and final agreements, remains an obligation in debt of the CCB.
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> The Support Package should have classified these moneys as an unrecoverable purchase price, as a capital grant of some nature or as a subordinated loan, repayable out of earnings only. What CCB needed at this time of crisis was a loan without recourse in the nature of a capital grant repayable only from future profits and not a loan which would retain that characteristic and revive when the bank ran into further difficulties.
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> . . . . .
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> The object of this Support Program therefore was to replace lost income and thereby protect and renew capital. The banks could not in law contribute equity capital, and the government agencies likewise were not in a position, either legally or practically, to do so. Resort was had to what amounted to a long-term loan repayable out of the prospects of collections from bad debts and future earnings. The money infused, therefore, could not be treated as capital, but only served to reduce liquidity advances.

66 Contrary to the legal representative's submissions, s. 13 of the participation agreement is not an attempt to enhance the ranking of the participants upon C.C.B.'s insolvency. As evidenced by the passages from this clause which I earlier emphasized, the main purpose and effect of s. 13 is to reduce, rather than enhance, the ranking of certain of the participants (Canada and Alberta) upon insolvency as the parties agreed to do away with s. 277 of the *Bank Act*. As for the other participants, there is nothing in s. 13 other than a confirmation that the ordinary principles of common law and of ss. 93 to 95 of the *Winding-up Act* apply upon insolvency, namely, the participants, as unsecured creditors of C.C.B., are entitled to rank pari passu with the other ordinary creditors of C.C.B.

67 For all the foregoing reasons, I find that the Court of Appeal did not err in characterizing the advance of $255 million to C.C.B. as being, in substance, a loan rather than an investment of capital. While indicia supporting both conclusions are present, the overall balance clearly tilts in favour of the characterization put forward by the respondents. Accordingly, I would dismiss this first ground of appeal.

B. Postponement under s. 4 of the Partnerships Act

68 In the alternative, the legal representative submits that, even if the advance of $255 million was properly characterized as a loan, the Court of Appeal erred in declining to postpone, under existing statutory and common law principles, the respondents' claims for the moneys not repaid until the claims of the other ordinary creditors of C.C.B. were satisfied. Relying on ss. 3(3)(*d*) and 4 of the *Partnerships Act*, he argues that, where a lender advances money to a business borrower under a contract providing that the lender shall "participate in the profits of that business," and the borrower subsequently becomes insolvent, the lender is not entitled to recover anything in respect of the loan until the claims of all other creditors of the borrower have been satisfied. It is submitted that the support agreements in question are contracts of such a nature because the participants contracted to be repaid their advances out of C.C.B.'s pre-tax income (either 50 per cent or 100 per cent plus interest, depending on whether the equity agreement could be carried out), and because of the potential for profits inherent in the warrants granted to the participants under the equity agreement.

69 As noted earlier, the Alberta Court of Appeal rejected a similar argument on the grounds that, notwithstanding the source for repayment and the warrants, the participants were *not* to receive under the agreements a "rate of interest

varying with the profits" or a "share of profits" (at p. 212). In other words, the loan in question was not one to which s. 4 of the *Partnerships Act* applied. The respondents before this court adopt a similar position on this issue.

70 Alberta argues, persuasively in my view, that a lender does not receive a "share of the profits" within the meaning of ss. 3(3)(*d*) and 4 of the Ontario *Partnerships Act* unless he or she is entitled to be paid amounts referable to profits other than in repayment of the principal amount of the loan. It is submitted that a lender does not share in profits merely by having a contingent right to acquire or possibly even by having the right to acquire or by owning shares of the borrower. In the case at bar, Alberta submits that all amounts which the participants were entitled to be paid were to be applied only in repayment of the principal amount due and hence they were not entitled to and did not share in C.C.B.'s profits. As for the bank group, it is submitted that in the case of the insolvency of a bank, the *Winding-up Act* and not the *Partnerships Act* or the *Bankruptcy Act* determine the priority of claims. Moreover, they argue that the transaction at hand is not one to which the *Partnerships Act* applies because the participation agreement referred to profits only as a means of determining the source of the participants' right to repayment, and because any alleged "share of the profits" would stop when the sum advanced was repaid.

71 I have already found that the Court of Appeal was correct in characterizing the advance of $255 million under the support program as a loan. In order to determine the applicability of s. 4 of the *Partnerships Act* to the facts of this case, a provision which may apply regardless of whether a partnership exists, the general question to be answered is whether this loan was made "upon such a contract as is mentioned in section 3" of the Act. If so, then, subject to any constitutional arguments not made herein, the respondents would not be entitled to recover anything in respect of the loan until the claims of the other ordinary creditors of C.C.B. are satisfied.

72 The only provisions in s. 3 of the *Partnerships Act* which make specific reference to a "contract" are s. 3(3)(*b*) and (*d*). Section 3(3)(*b*) is clearly irrelevant to this appeal. Thus, at least at first glance, the contracts in the case at bar must fall within the ambit of s. 3(3)(*d*) of the *Partnerships Act* in order to trigger the application of s. 4. The specific question then becomes whether or not the support agreements provided that the participants were to receive a "rate of interest varying with the profits" of C.C.B, or a "share of the profits arising from carrying on the business" of C.C.B. While the legal representative originally structured his s. 4 argument exclusively around the wording in s. 3(3)(*d*) of the *Partnerships Act*, he expanded this argument during oral submissions to include s. 3(3)(*a*). He submitted that, even if the transaction does not fall within the ambit of the former subsection, it clearly falls within the latter. Accordingly, another specific question to be considered is whether s. 4 of the *Partnerships Act* can be triggered by "the receipt by a person of a debt or other liquidated amount by instalments or otherwise out of the accruing profits of a business" which does not involve a contract of the sort described in s. 3(3)(*d*). I will deal with both of these questions in turn.

73 Sections 3(3)(*d*) and 4 of the *Partnerships Act* originate from the now repealed *Act to Amend the Law of Partnership*, 1865 (U.K.), 28 & 29 Vict., c. 86 ("Bovill's Act"). The intent of what is now s. 3 of the *Partnerships Act* was evidently to mitigate the harshness of the old common law rule, which was that any person who shared in the profits of the partnership was deemed to be a partner, and so liable for any debts of the partnership on insolvency: *Grace v. Smith* (1775), 2 Wm. Bl. 997, 96 E.R. 587 (at p. 588 per De Grey C.J.: "Every man who has a share of the profits of a trade ought also to bear his share of the loss"); and *Waugh v. Carver* (1793), 2 Hy. Bl. 235, 126 E.R. 525.

74 The old common law rule was first modified by the decision in *Cox v. Hickman* (1860), 8 H.L.C. 268, 11 E.R. 431, which in some respects was very similar on the facts to the present case. The company of Smith and Son fell into financial difficulties and was unable to pay its creditors. The Smiths entered into an arrangement with five of its creditors assigning the company to them (as trustees for all of the creditors), for a term of 21 years. During that period, the trustees were to carry on the business of the company "and to pay the net income, after answering all expenses; which net income was always to be deemed the property of the two Smiths, among [all] the creditors of the Smiths" (at p. 269) [H.L.C.]. In other words, the creditors "were to be paid their debts out of the profits of their debtors' business" (*Lindley on the Law of Partnership*, 15th ed. (London: Sweet & Maxwell, 1984), at p. 104). The most significant fact for our purposes is that the repayment was to be only to the extent of the debts; when all the debts had been paid, the trustees were to

hold the estate in trust for the Smiths. Financial troubles continued under the new management, and the company once again became unable to pay its debts.

75 Since at that time the law was thought to be that a person who shared in the profits was liable as a partner, the question in *Cox v. Hickman*, supra, was not, as here, whether those creditors who were being paid out of profits were to be ranked equally with subsequent creditors, but whether the former group were to be themselves liable as partners to subsequent creditors. In deciding that they were not so liable, the House of Lords is considered to have established, amongst other things, that receipt of a share of the profits is not conclusive proof of a partnership as was previously thought (*Lindley on the Law of Partnership*, at p. 104).

76 However, it is interesting to note one excerpt of the opinion of Wightman J. (one of the judges who came to advise the House of Lords in *Cox v. Hickman*) who, instead of modifying the old common rule, would simply have not applied it to the facts of the case (at p. 443 E.R.):

> It is said that a person who shares in net profits is a partner; that may be so in some cases, but not in all; and it may be material to consider in what sense the words, 'sharing in the profits' are used. In the present case, I greatly doubt whether the creditor, who merely obtains payment of a debt incurred in the business by being paid the exact amount of his debt, and no more, out of the profits of the business, can be said to share the profits. If in the present case, the property of the Smiths had been assigned to the trustees to carry on the business, and divide the net profits, not amongst those creditors who signed the deed, but amongst all the creditors, until their debts were paid, would a creditor, by receiving from time to time a rateable proportion out of the net profits, become a partner? I should think not.

In my view, the undesirability of the result foreseen by Wightman J. is equally compelling in the context of ss. 3(3)(*d*) and 4 of the *Partnerships Act*.

77 Historically, s. 3(3)(*d*) of the *Partnerships Act* appears to refer to loans similar to those involved in *Sukloff v. Rushforth*, supra, namely, loans in which the creditor advances money to the debtor on the terms that it shall be repaid with interest, and in addition the creditor is to receive a share of the profits over and above any payments on principal until the amount is paid off, as opposed to loans such as those in the present case where the share of the profits is used solely to repay the principal. In other words, s. 3(3)(*d*) applied to loans which had no cap or limit on the amount to be paid to the creditor from the profits of the debtor's business or which had a cap unrelated to the principal owing on the debt.

78 It is not entirely clear in *Sukloff v. Rushforth*, supra, whether the lender actually received any of the profits of the company via the arrangement for 50 per cent of the profits. However, in many older cases it is clear that the lender did receive interest and the stated share of the profits for a period, and then claimed for the *entire amount* of the principal on bankruptcy of the debtor. In these cases ss. 2(3)(*d*) and 3 of the *Partnership Act*, 1890 (U.K.), 53 & 54 Vict., c. 39 (similar to ss. 3(3)(*d*) and 4 of the *Partnerships Act*) were applied to subordinate the claims: see *Ex parte Taylor; Re Grason* (1879), 12 Ch. D. 366 (C.A.); *Re Stone* (1886), 33 Ch. D. 541; *Re Hildesheim*, [1893] 2 Q.B. 357 (C.A.); *Re Mason; Ex parte Bing*, [1899] 1 Q.B. 810; and *Re Fort; Ex parte Schofield*, [1897] 2 Q.B. 495 (C.A.). These sections of the *Partnership Act*, 1890 essentially repeated Bovill's Act so it seems reasonable that this was the specific situation envisaged by the Act.

79 Contrary to the oral submission of the legal representative, *Re Young; Ex parte Jones*, [1896] 2 Q.B. 484, is not inconsistent with the distinction I am drawing. There, Mr. Jones lent money to Mr. Young which was to be used to pay the expenses of Mr. Young's business. The terms of the agreement provided that, in return for the use of this sum, Jones was to be paid a fixed weekly sum out of the profits of the business. When Young became insolvent, Jones claimed for the entire amount of principal, without making allowance for the amounts received by virtue of the weekly payments. In other words, the weekly sum received by Jones out of profits was not for the purpose of repaying the principal sum of the debt. Thus, *Re Young* is clearly distinguishable from the facts of this case and should not be seen as foreclosing the interpretation of s. 3(3)(*d*) that I am advancing.

80 In addition, s. 3(3)(*a*) of the *Partnerships Act* provides strong support for the distinction between profits as the source of repayment, and a share in the profits, with any repayment of a fixed debt falling into the former category. Indeed, it provides that:

> (*a*) the receipt by a person of a debt or other liquidated amount by instalments or otherwise out of the accruing profits of a business does not of itself make him or her a partner in the business or liable as such.

This seems to preclude any reading of s. 3(3)(*d*) which would catch debts which are to be repaid "out of profits." In this respect, it is interesting to note that the authors of *Lindley on the Law of Partnership* are of the view that the equivalent of s. 3(3)(*a*), not s. 3(3)(*d*), applies to cases such as *Cox v. Hickman*, supra, where, as we have seen, an arrangement similar to the one at bar was involved (at p. 108).

81 For the foregoing reasons, I would conclude that any fixed debt to be repaid out of profits does not in itself constitute a "share of the profits" within the meaning of s. 3(3)(*d*) of the *Partnerships Act*. As argued by Alberta, a lender does not receive a "share of the profits" under this provision unless he or she is entitled to be paid amounts referable to profits other than in repayment of the principal amount of the loan.

82 Having said this, the question of whether the support agreements provided that the participants were to receive a "rate of interest varying with the profits" of C.C.B., or a "share of the profits arising from carrying on the business" of C.C.B., as to trigger s. 4 of the *Partnerships Act*, may be readily answered. Clearly, the participants were not to receive in return for the advance of $255 million a rate of interest varying with C.C.B.'s profits. The rate of interest to be paid was fixed according to the prime rate and was contingent on whether or not the equity agreement could be carried out. As for C.C.B.'s profits, they merely represented the source from which the participants were to be repaid their advance. In this respect, I entirely agree with the following excerpt taken from the reasons of Harradence J.A. in the case at bar (at p. 211):

> It is important to recognize that while repayment was to be made from pre-tax income of C.C.B., there was no direct link between the success of the C.C.B. and the overall quantum of the amount due to or payable to the Support Group Participants. I have been referred to no authority which supports the proposition that a repayment, the instalments of which are referable to the quantum of the income of the debtor, is a situation of 'joint benefit'. Since the sums to be received by the Participants were limited to repayment of monies advanced, with a contingent right to interest, the source of the repayment monies is not relevant and, with respect, the learned Chambers Judge erred in concluding the Participants were 'sharing the profits' in this respect.

83 The participants had a fixed debt which would be repaid in part by the moneys received from the syndicated portion of the portfolio assets and in part by C.C.B.'s pre-tax income. With the exception of the contingent interest at prime rate, under no circumstances were the payments from the pre-tax income to be applied to anything but the repayment of the loan. All amounts that the participants were entitled to be paid were to be applied only in repayment of the principal amount of the loan. Once the loan was fully repaid, all payments from C.C.B.'s pre-tax income were to stop. Accordingly, I find that the participants were not to receive a "share of the profits" of C.C.B. within the meaning of s. 3(3)(*d*) of the *Partnerships Act* by virtue of the repayment scheme for the $255 million advance. I also do not accept that the contemplated granting of warrants under the highly contingent circumstances of this case alters this conclusion.

84 The question then is whether s. 4 of the *Partnerships Act* can be triggered by an arrangement falling under s. 3(3)(*a*). Indeed, as previously noted, the legal representative takes the alternative position that, even if s. 3(3)(*d*) does not apply, the transaction in this case is surely one contemplating "the receipt by a person of a debt or other liquidated amount by instalments or otherwise out of the accruing profits of a business." While one cannot seriously dispute this proposition, the fact remains that s. 4 cannot apply unless "money has been advanced by way of loan upon such a contract as is mentioned in section 3." The first point to note is that s. 3(3)(*a*) of the *Partnerships Act* makes no reference whatsoever to a "contract" and thus appears to be beyond the realm of s. 4. Clearly, the legislature could have chosen a more general term than "contract" in s. 4 had it wished this postponement provision to apply to every transaction described in s. 3.

The same could also be said about the absence of the word "loan" in s. 3(3)(*a*). It is not without significance that we were not presented with any jurisprudence in which a person who had a fixed debt to be paid out of profits (i.e., who would fall under s. 3(3)(*a*) and not s. 3(3)(*d*)) was subordinated under the Act.

85 Further, if the policy on which s. 4 of the *Partnerships Act* is based is that a person who reaps the rewards of profits must share some risk, then this would not apply to a creditor with a fixed debt, notwithstanding that the fund or source of repayment is profits, because his or her total return will not vary with the profitability of the company.

86 From the above, I conclude that s. 4 of the *Partnerships Act* cannot be triggered by what is described in s. 3(3)(*a*) as "the receipt by a person of a debt or other liquidated amount by instalments or otherwise out of the accruing profits of a business," which does not involve a contract of the sort described in s. 3(3)(*d*). The present case may very well fall within s. 3(3)(*a*) of the Act. However, that section only deals with a guideline for determining whether or not a partnership has been created, an issue which is not raised in this appeal. Contrary to s. 3(3)(*d*) of the *Partnerships Act*, s. 3(3)(*a*) does not have the added function of triggering the postponement provision of the Act. As the participants were not to receive a "rate of interest varying with the profits" of C.C.B. or a "share of the profits arising from carrying on the business" of C.C.B., their claims for the return of the moneys advanced cannot be postponed under s. 4.

87 Accordingly, I would dismiss this ground of appeal. The Court of Appeal did not err in declining to postpone the respondents' claims under s. 4 of the *Partnerships Act*.

C. Equitable subordination

88 In the further alternative, the legal representative submits that even if the transaction in question is a loan and the *Partnerships Act* does not apply, the participants' claims should be subordinated on equitable grounds based on the United States doctrine of "equitable subordination."

89 More specifically, it is argued that the equitable jurisdiction of superior courts gives them authority in insolvency matters to subordinate claims that, while valid as against the insolvent's estate, arise from or are connected with conduct prejudicial to the interests of other creditors. While the legal representative does not assert that the conduct of the participants was fraudulent or worthy of censure, he argues that the participants acted to the detriment of the ordinary creditors of C.C.B. in ways (which I shall outline below) that should invoke this equitable jurisdiction. Both the bank group and Alberta challenge the proposition that equitable subordination is available under Canadian law in insolvency matters. In addition, the respondents argue that the facts of this case do not call for the application of equitable principles.

90 This issue does not appear to have been raised before Wachowich J. or the Court of Appeal and consequently this court does not have the benefit of any findings of fact as to the actual or potential prejudice suffered by C.C.B.'s depositors and other creditors as a result of the conduct of the participants. In this respect, the evidence presented to this court by the legal representative is limited to certain excerpts of the Estey report, incorporated by reference in the affidavit of Mr. Allan Taylor of the Royal Bank of Canada (C.O.A. at pp. 236-41). The excerpts in question are those found at pp. 114-21 of the Estey report under the heading "Flaws in the Support Program."

91 This court also does not have the benefit of the insight of the courts below as to whether or not, in the first place, the doctrine of equitable subordination should become part of Canadian insolvency law. As I see the matter, however, it is not necessary in the circumstances of this case to answer the question of whether a comparable equitable doctrine should exist in Canadian law and I expressly refrain from doing so. Assuming, for the sake of argument only, that Canadian courts have the power in insolvency matters to subordinate otherwise valid claims to those of other creditors on equitable grounds relating to the conduct of these creditors inter se, this court has been presented with insufficient grounds to justify the exercise of such a power in the case at bar. Briefly put, the reasons and limited evidence advanced by the legal representative before this court disclose neither inequitable conduct on the part of the participants nor injury to the ordinary creditors of C.C.B. as a result of the alleged misconduct.

92 As I understand it, in the United States there are three requirements for a successful claim of equitable subordination: (1) the claimant must have engaged in some type of inequitable conduct; (2) the misconduct must have resulted in injury to the creditors of the bankrupt or conferred an unfair advantage on the claimant; and (3) equitable subordination of the claim must not be inconsistent with the provisions of the bankruptcy statute: see *Re Mobile Steel Co.*, 563 F. 2d 692 (5th Circ., 1977), at p. 700; *Re Multiponics Inc.*, 622 F. 2d 709 (5th Circ., 1980); A. DeNatale and P.B. Abram, "The Doctrine of Equitable Subordination as Applied to Nonmanagement Creditors" (1985), 40 Bus. Law. 417, at p. 423; and L.J. Crozier, "Equitable Subordination of Claims in Canadian Bankruptcy Law" (1992), 7 C.B.R. (3d) 40, at pp. 41-42. Even if this court were to accept that a comparable doctrine to equitable subordination should exist in Canadian law, I do not view the facts of this case as giving rise to the "inequitable conduct" and ensuring "detriment" necessary to trigger its application.

93 In this regard, the actions cited by the legal representative as being detrimental to the ordinary creditors of C.C.B., thereby giving rise to equitable subordination, come down to two elements: (1) the press release of March 25, 1985 issued by the Department of Finance announcing to the general public that the support program would leave C.C.B. "in a strong position of solvency" and that sufficient funds were being advanced "to ensure solvency"; and (2) the flaws in the support program outlined in the Estey report and described by the legal representative as (a) the inadequacy of the support program to ensure C.C.B.'s solvency, (b) the accounting treatment disguised the fact that the participation agreement required the entire amount advanced to be repaid, (c) the accounting treatment used by the bank group gave rise to tax benefits not available to ordinary depositors, (d) the participation agreement allegedly obliged C.C.B. to apply all amounts received on the syndicated portion of the portfolio assets to the participants, (e) the warrants would have the effect of prohibiting C.C.B. from raising funds in the equity market since they would enable the participants to acquire 75 per cent of the common shares of C.C.B. up to 10 years after the advances had been paid in full, and (f) after making their advances and receiving their participation certificates, the bank group ceased dealing with C.C.B. in the normal manner.

94 At the outset, I note that many of the actions relied on by the legal representative cannot be attributable to the participants. For example, the press release was not issued by the respondents and the accounting treatment given by C.C.B. to the advance of $255 million simply followed the instructions given by the Office of the Inspector General of Banks. Thus, even if some inequitable connotation could be given to these actions, they would not represent misconduct on the part of the respondents to whom the ordinary creditors of C.C.B. are now attempting to rank in priority.

95 Another difficulty with the legal representative's submission, however, is that I fail to see anything remotely inequitable in the conduct complained of. With respect to the press release, the evidence does not show that the participants were necessarily of a different opinion from that set out in the press release. Certainly, they advanced the funds on the condition that the Inspector General of Banks provide them with an opinion letter confirming the solvency of C.C.B. on the infusion of the proposed funds. As for the flaws in the support program, there is nothing to show that the participants' plans were other than well intentioned. As stated at the beginning of these reasons, it is beyond the scope of this appeal to engage in a detailed review of the reasons which led to the failure of the support program. Suffice it to say that the assertions of the legal representative in substance do not show wrongdoing or unfairness on the part of the participants, but merely show that the support program did not work, and perhaps with hindsight, offer some explanations as to why.

96 In any event, it does not appear to have been suggested at any time in the courts below nor was any evidence led to suggest that any creditor of C.C.B. was misled by any of the above actions or that the press release, accounting treatment or any flaw in the support program operated to cause any creditor to act to its detriment. Thus, even if this court were to find that the participants acted in an inequitable manner in their dealings with C.C.B. and its depositors and other creditors, we do not have a shred of evidence upon which to conclude that the improper conduct resulted in actual harm to the ordinary creditors of C.C.B. now before this court. One can only speculate that depositors and other creditors relied on the press release or accounting treatment and thereby suffered damages. We have been offered no United States' decision in which mere speculation of harm to other creditors has been found sufficient to meet the second requirement of the doctrine of equitable subordination. Of course, the ordinary creditors of C.C.B. who appear before this court

have, to a varying extent, suffered from the winding-up of C.C.B., just as any creditor (including the participants) suffers following an insolvency or bankruptcy. The legal representative has not shown, however, that these ordinary creditors have suffered identifiable prejudice attributable specifically to the alleged misconduct of the participants.

97 Accordingly, I would reject this alternative ground of appeal. Even if equitable subordination is available under Canadian law, a question which I leave open for another day, the facts of this case do not call for an intervention with the pari passu ranking of the respondents in the name of equity.

D. The $5 million attributable to the syndicated portion of the portfolio assets

98 The last matter to be addressed pertains to the moneys recovered from the portfolio assets and attributable to the syndicated portion thereof. In his oral submissions, the legal representative argued that the learned chambers judge erred in allowing the participants to recover funds from the syndicated portion of the portfolio assets. A similar submission was made in the Alberta Court of Appeal but was summarily rejected (at p. 212). As I understand it, the argument is one of inconsistency between the treatment given, on the one hand, to the respondents' claim for their portion of the moneys recovered from the portfolio assets and, on the other hand, to the respondents' claim for all moneys advanced to C.C.B. pursuant to the participation agreement and not repaid by moneys recovered from the portfolio assets. According to the legal representative, these two claims stem from the same financial arrangement and cannot be given different legal effects. It is argued that, if the advance of $255 million is really an investment of capital, as found by Wachowich J., then it is wrong to rank the respondents behind the ordinary creditors of C.C.B. only with respect to the claim for what is not repaid by moneys recovered from the portfolio assets. Similarly, if the transaction is really a loan but the loan is one to which s. 4 of the *Partnerships Act* applies, then both claims ought to be postponed.

99 This submission has already been answered by my conclusion that the advance of $255 million to C.C.B. was substantially in the nature of a loan and that the *Partnerships Act* does not apply to postpone the loan.

VI. Disposition

100 For the foregoing reasons, I would dismiss the appeal with costs here and in the courts below. As found by the learned chambers judge and upheld by the Court of Appeal, the participants are entitled to their proportionate share of the moneys recovered from the portfolio assets of C.C.B. in the manner set out in the participation agreement, that is, to the extent such recoveries exceed the C.C.B. portion of each of the portfolio assets. Moreover, as found by the Court of Appeal, the respondents are entitled to rank pari passu with the ordinary creditors of C.C.B. for all moneys advanced pursuant to the participation agreement and not repaid by moneys recovered from the portfolio assets.

Appeal dismissed.

Footnotes

* Stevenson J. took no part in the judgment.

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2013 SCC 6
Supreme Court of Canada

Indalex Ltd., Re

2013 CarswellOnt 733, 2013 CarswellOnt 734, 2013 SCC 6, [2013] 1 S.C.R. 271, [2013] W.D.F.L. 1591, [2013] W.D.F.L. 1592, [2013] S.C.J. No. 6, 20 P.P.S.A.C. (3d) 1, 223 A.C.W.S. (3d) 1049, 2 C.C.P.B. (2nd) 1, 301 O.A.C. 1, 354 D.L.R. (4th) 581, 439 N.R. 235, 8 B.L.R. (5th) 1, 96 C.B.R. (5th) 171, J.E. 2013-185, D.T.E. 2013T-97

Sun Indalex Finance, LLC (Appellant) and United Steelworkers, Keith Carruthers, Leon Kozierok, Richard Benson, John Faveri, Ken Waldron, John (Jack) W. Rooney, Bertram McBride, Max Degen, Eugene D'Iorio, Neil Fraser, Richard Smith, Robert Leckie and Fred Granville (Respondents)

George L. Miller, the Chapter 7 Trustee of the Bankruptcy Estates of the U.S. Indalex Debtors (Appellant) and United Steelworkers, Keith Carruthers, Leon Kozierok, Richard Benson, John Faveri, Ken Waldron, John (Jack) W. Rooney, Bertram McBride, Max Degen, Eugene D'Iorio, Neil Fraser, Richard Smith, Robert Leckie and Fred Granville (Respondents)

FTI Consulting Canada ULC, in its capacity as court-appointed monitor of Indalex Limited, on behalf of Indalex Limited (Appellant) and United Steelworkers, Keith Carruthers, Leon Kozierok, Richard Benson, John Faveri, Ken Waldron, John (Jack) W. Rooney, Bertram McBride, Max Degen, Eugene D'Iorio, Neil Fraser, Richard Smith, Robert Leckie and Fred Granville (Respondents)

United Steelworkers (Appellant) and Morneau Shepell Ltd. (formerly known as Morneau Sobeco Limited Partnership) and Superintendent of Financial Services (Respondents) and Superintendent of Financial Services, Insolvency Institute of Canada, Canadian Labour Congress, Canadian Federation of Pensioners, Canadian Association of Insolvency and Restructuring Professionals and Canadian Bankers Association (Interveners)

McLachlin C.J.C., LeBel, Deschamps, Abella, Rothstein, Cromwell, Moldaver JJ.

Heard: June 5, 2012
Judgment: February 1, 2013
Docket: 34308

Proceedings: reversing *Indalex Ltd., Re* (2011), 89 C.C.P.B. 39, 276 O.A.C. 347, 331 D.L.R. (4th) 352, 17 P.P.S.A.C. (3d) 194, 75 C.B.R. (5th) 19, 104 O.R. (3d) 641, 2011 C.E.B. & P.G.R. 8433, 2011 ONCA 265, 2011 CarswellOnt 2458 (Ont. C.A.); reversing *Indalex Ltd., Re* (2010), 79 C.C.P.B. 301, 2010 ONSC 1114, 2010 CarswellOnt 893 (Ont. S.C.J. [Commercial List]); and reversing in part *Indalex Ltd., Re* (2011), 81 C.B.R. (5th) 165, 92 C.C.P.B. 277, 2011 ONCA 578, 2011 CarswellOnt 9077 (Ont. C.A.); additional reasons to *Indalex Ltd., Re* (2011), 89 C.C.P.B. 39, 276 O.A.C. 347, 331 D.L.R. (4th) 352, 17 P.P.S.A.C. (3d) 194, 75 C.B.R. (5th) 19, 104 O.R. (3d) 641, 2011 C.E.B. & P.G.R. 8433, 2011 ONCA 265, 2011 CarswellOnt 2458 (Ont. C.A.)

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Darrell L. Brown, for Appellant / Respondent, United Steelworkers
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Robert I. Thornton, D.J. Miller, for Intervener, Insolvency Institute of Canada
Steven Barrett, Ethan Poskanzer, for Intervener, Canadian Labour Congress
Kenneth T. Rosenberg, Andrew K. Lokan, Massimo Starnino, for Intervener, Canadian Federation of Pensioners
Éric Vallières, Alexandre Forest, Yoine Goldstein, for Intervener, Canadian Association of Insolvency and Restructuring Professionals
Mahmud Jamal, Jeremy Dacks, Tony Devir, for Intervener, Canadian Bankers Association

Subject: Insolvency; Estates and Trusts; Family; Property; Corporate and Commercial; Employment; Civil Practice and Procedure; Constitutional; International

Headnote

Bankruptcy and insolvency --- Property of bankrupt — Trust property — Miscellaneous

Pensions — I Ltd. was part of group of companies that became insolvent — Bankruptcy protection was sought — I Ltd. was administrator of two registered pension plans — Salaried plan was in process of being wound up when Companies' Creditors Arrangement Act proceedings began — Executive plan was closed but not wound up — Amended initial order was obtained, authorizing I Ltd. to borrow from debtor-in-possession ("DIP") lenders and granting them priority over all other creditors — Pension plan members brought unsuccessful motions for declaration that deemed trust equal to unfunded pension liability was enforceable against proceeds of sale of assets of I Ltd. — In allowing plan members' appeal, Court of Appeal ordered distribution from reserve fund in order to pay amount of each plan's deficiency — I Ltd., monitor, secured creditor, and trustee in bankruptcy appealed order — Appeal allowed — With respect to salaried plan, I Ltd. was deemed to hold in trust amount necessary to satisfy wind-up deficiency — Deemed trust did not apply to wind-up deficiency with respect to executive plan — As result of application of doctrine of federal paramountcy, DIP charge superseded deemed trust.

Bankruptcy and insolvency --- Property of bankrupt — Pension funds

Trusts — I Ltd. was part of group of companies that became insolvent — Bankruptcy protection was sought — I Ltd. was administrator of two registered pension plans — Salaried plan was in process of being wound up when Companies' Creditors Arrangement Act proceedings began — Executive plan was closed but not wound up — Amended initial order was obtained, authorizing I Ltd. to borrow from debtor-in-possession ("DIP") lenders and granting them priority over all other creditors — Pension plan members brought unsuccessful motions for declaration that deemed trust equal to unfunded pension liability was enforceable against proceeds of sale of assets of I Ltd. — In allowing plan members' appeal, Court of Appeal ordered distribution from reserve fund in order to pay amount of each plan's deficiency — I Ltd., monitor, secured creditor, and trustee in bankruptcy appealed order — Appeal allowed — With respect to salaried plan, I Ltd. was deemed to hold in trust amount necessary to satisfy wind-up deficiency — Deemed trust did not apply to wind-up deficiency with respect to executive plan — As result of application of doctrine of federal paramountcy, DIP charge superseded deemed trust.

Pensions --- Administration of pension plans — Administrators, trustees and custodians — Fiduciary duties — Miscellaneous

I Ltd. was part of group of companies that became insolvent — Bankruptcy protection was sought — I Ltd. was administrator of two registered pension plans — Salaried plan was in process of being wound up when Companies' Creditors Arrangement Act proceedings began — Executive plan was closed but not wound up — Amended initial order was obtained, authorizing I Ltd. to borrow from debtor-in-possession ("DIP") lenders and granting them priority over all other creditors — Pension plan members brought unsuccessful motions for declaration that deemed trust equal to unfunded pension liability was enforceable against proceeds of sale of assets of I Ltd. — In allowing plan members' appeal, Court of Appeal ordered distribution from reserve fund in order to pay amount of each plan's deficiency — I Ltd., monitor, secured creditor, and trustee in bankruptcy appealed order — Appeal allowed — I Ltd.'s fiduciary obligations as plan administrator conflicted with management decisions that needed to be taken in best interests of corporation — I Ltd. should have taken steps to ensure that interests of plan members were protected, but did not do so — With respect to salaried plan, I Ltd. was deemed to hold in trust amount necessary to satisfy wind-up deficiency, but DIP charge superseded deemed trust by application of doctrine of federal paramountcy.

Pensions --- Administration of pension plans — Administrators, trustees and custodians — Fiduciary duties — Liabilities for breach

I Ltd. was part of group of companies that became insolvent — Bankruptcy protection was sought — I Ltd. was administrator of two registered pension plans — Salaried plan was in process of being wound up when Companies' Creditors Arrangement Act proceedings began — Executive plan was closed but not wound up — Amended initial order was obtained, authorizing I Ltd. to borrow from debtor-in-possession ("DIP") lenders and granting them priority over all other creditors — Pension plan members brought unsuccessful motions for declaration that deemed trust equal to unfunded pension liability was enforceable against proceeds of sale of assets of I Ltd. — In allowing plan members' appeal, Court of Appeal ordered distribution from reserve fund in order to pay amount of each plan's deficiency — I Ltd., monitor, secured creditor, and trustee in bankruptcy appealed order — Appeal allowed — I Ltd.'s fiduciary obligations as plan administrator conflicted with management decisions that needed to be taken in best interests of corporation — I Ltd. should have taken steps to ensure that interests of plan members were protected, but did not do so — Constructive trust remedy was not available, as required condition was not met — With respect to salaried plan, I Ltd. was deemed to hold in trust amount necessary to satisfy wind-up deficiency, but DIP charge superseded deemed trust by application of doctrine of federal paramountcy.

Pensions --- Administration of pension plans — Administrators, trustees and custodians — Miscellaneous

I Ltd. was part of group of companies that became insolvent — Bankruptcy protection was sought — I Ltd. was administrator of two registered pension plans — Salaried plan was in process of being wound up when Companies' Creditors Arrangement Act proceedings began — Executive plan was closed but not wound up — Amended initial order was obtained, authorizing I Ltd. to borrow from debtor-in-possession ("DIP") lenders and granting them priority over all other creditors — Pension plan members brought unsuccessful motions for declaration that deemed trust equal to unfunded pension liability was enforceable against proceeds of sale of assets of I Ltd. — In allowing plan members' appeal, Court of Appeal ordered distribution from reserve fund in order to pay amount of each plan's deficiency — I Ltd., monitor, secured creditor, and trustee in bankruptcy appealed order — Appeal allowed — I Ltd.'s fiduciary obligations as plan administrator conflicted with management decisions that needed to be taken in best interests of corporation — I Ltd. should have taken steps to ensure that interests of plan members were protected, but did not do so — With respect to salaried plan, I Ltd. was deemed to hold in trust amount necessary to satisfy wind-up deficiency, but DIP charge superseded deemed trust by application of doctrine of federal paramountcy.

Bankruptcy and insolvency --- Practice and procedure in courts — Appeals — Miscellaneous

Collateral attack doctrine — I Ltd. was part of group of companies that became insolvent — Bankruptcy protection was sought — I Ltd. was administrator of two registered pension plans — Salaried plan was in process of being wound up when Companies' Creditors Arrangement Act proceedings began — Executive plan was closed but not wound up — Amended initial order was obtained, authorizing I Ltd. to borrow from debtor-in-possession ("DIP") lenders and granting them priority over all other creditors — Pension plan members brought unsuccessful motions for declaration that deemed trust equal to unfunded pension liability was enforceable against proceeds of sale of assets of I Ltd. — In allowing plan members' appeal, Court of Appeal ordered distribution from reserve fund in order to pay amount of each plan's deficiency — I Ltd., monitor, secured creditor, and trustee in bankruptcy appealed order — Appeal allowed — It could not be argued that plan members were barred from defending their interests by collateral attack doctrine — Argument that plan members should have appealed amended initial order authorizing

DIP charge, and were precluded from subsequently arguing that their claim ranked in priority to that of DIP lenders, was not convincing — With respect to salaried plan, I Ltd. was deemed to hold in trust amount necessary to satisfy wind-up deficiency, but DIP charge superseded deemed trust by application of doctrine of federal paramountcy.

Bankruptcy and insolvency --- Administration of estate — Sale of assets — Miscellaneous

Distribution of proceeds — I Ltd. was part of group of companies that became insolvent — Bankruptcy protection was sought — I Ltd. was administrator of two registered pension plans — Salaried plan was in process of being wound up when Companies' Creditors Arrangement Act proceedings began — Executive plan was closed but not wound up — Amended initial order was obtained, authorizing I Ltd. to borrow from debtor-in-possession ("DIP") lenders and granting them priority over all other creditors — Pension plan members brought unsuccessful motions for declaration that deemed trust equal to unfunded pension liability was enforceable against proceeds of sale of assets of I Ltd. — In allowing plan members' appeal, Court of Appeal ordered distribution from reserve fund in order to pay amount of each plan's deficiency — I Ltd., monitor, secured creditor, and trustee in bankruptcy appealed order — Appeal allowed — With respect to salaried plan, I Ltd. was deemed to hold in trust amount necessary to satisfy wind-up deficiency — Deemed trust did not apply to wind-up deficiency with respect to executive plan — As result of application of doctrine of federal paramountcy, DIP charge superseded deemed trust.

Personal property security --- Priority of security interest — Security interests versus other interests — Under provincial law — Statutory and deemed trusts

Companies' Creditors Arrangement Act — I Ltd. was part of group of companies that became insolvent — Bankruptcy protection was sought — I Ltd. was administrator of two registered pension plans — Salaried plan was in process of being wound up when Companies' Creditors Arrangement Act proceedings began — Executive plan was closed but not wound up — Amended initial order was obtained, authorizing I Ltd. to borrow from debtor-in-possession ("DIP") lenders and granting them priority over all other creditors — Pension plan members brought unsuccessful motions for declaration that deemed trust equal to unfunded pension liability was enforceable against proceeds of sale of assets of I Ltd. — In allowing plan members' appeal, Court of Appeal ordered distribution from reserve fund in order to pay amount of each plan's deficiency — I Ltd., monitor, secured creditor, and trustee in bankruptcy appealed order — Appeal allowed — With respect to salaried plan, I Ltd. was deemed to hold in trust amount necessary to satisfy wind-up deficiency — Deemed trust did not apply to wind-up deficiency with respect to executive plan — As result of application of doctrine of federal paramountcy, DIP charge superseded deemed trust.

Bankruptcy and insolvency --- Priorities of claims — Preferred claims — Wages and salaries of employees — Creation of statutory trust

Pension plans — I Ltd. was part of group of companies that became insolvent — Bankruptcy protection was sought — I Ltd. was administrator of two registered pension plans — Salaried plan was in process of being wound up when Companies' Creditors Arrangement Act proceedings began — Executive plan was closed but not wound up — Amended initial order was obtained, authorizing I Ltd. to borrow from debtor-in-possession ("DIP") lenders and granting them priority over all other creditors — Pension plan members brought unsuccessful motions for declaration that deemed trust equal to unfunded pension liability was enforceable against proceeds of sale of assets of I Ltd. — In allowing plan members' appeal, Court of Appeal ordered distribution from reserve fund in order to pay amount of each plan's deficiency — I Ltd., monitor, secured creditor, and trustee in bankruptcy appealed order — Appeal allowed — With respect to salaried plan, I Ltd. was deemed to hold in trust amount necessary to satisfy wind-up deficiency — Deemed trust did not apply to wind-up deficiency with respect to executive plan — As result of application of doctrine of federal paramountcy, DIP charge superseded deemed trust.

Bankruptcy and insolvency --- Bankruptcy and insolvency jurisdiction — Constitutional jurisdiction of Federal government and provinces — Paramountcy of Federal legislation

I Ltd. was part of group of companies that became insolvent — Bankruptcy protection was sought — I Ltd. was administrator of two registered pension plans — Salaried plan was in process of being wound up when Companies'

Creditors Arrangement Act ("CCAA") proceedings began — Executive plan was closed but not wound up — Amended initial order was obtained, authorizing I Ltd. to borrow from debtor-in-possession ("DIP") lenders and granting them priority over all other creditors — Pension plan members brought unsuccessful motions for declaration that deemed trust equal to unfunded pension liability was enforceable against proceeds of sale of assets of I Ltd. — In allowing plan members' appeal, Court of Appeal ordered distribution from reserve fund in order to pay amount of each plan's deficiency — I Ltd., monitor, secured creditor, and trustee in bankruptcy appealed order — Appeal allowed — With respect to salaried plan, I Ltd. was deemed to hold in trust amount necessary to satisfy wind-up deficiency, but DIP charge superseded deemed trust by application of doctrine of federal paramountcy — Federal and provincial laws were inconsistent, as they gave rise to different, and conflicting, orders of priority — Section 30(7) of Personal Property Security Act required part of proceeds from asset sale to be paid to plan's administrator before other secured creditors were paid — However, amended initial order provided that DIP charge ranked in priority to all other security interests, trusts, liens, charges and encumbrances, statutory or otherwise — This court-ordered priority based on CCAA had same effect as statutory priority.

Estates and trusts --- Trusts — Constructive trust — Gains by fiduciaries

Breach of fiduciary duty — I Ltd. was part of group of companies that became insolvent — Bankruptcy protection was sought — I Ltd. was administrator of two registered pension plans — Salaried plan was in process of being wound up when Companies' Creditors Arrangement Act proceedings began — Executive plan was closed but not wound up — Amended initial order was obtained, authorizing I Ltd. to borrow from debtor-in-possession ("DIP") lenders and granting them priority over all other creditors — Pension plan members brought unsuccessful motions for declaration that deemed trust equal to unfunded pension liability was enforceable against proceeds of sale of assets of I Ltd. — In allowing plan members' appeal, Court of Appeal ordered distribution from reserve fund in order to pay amount of each plan's deficiency — I Ltd., monitor, secured creditor, and trustee in bankruptcy appealed order — Appeal allowed — I Ltd.'s fiduciary obligations as plan administrator conflicted with management decisions that needed to be taken in best interests of corporation — I Ltd. should have taken steps to ensure that interests of plan members were protected, but did not do so — Constructive trust remedy was not available, as required condition was not met — With respect to salaried plan, I Ltd. was deemed to hold in trust amount necessary to satisfy wind-up deficiency, but DIP charge superseded deemed trust by application of doctrine of federal paramountcy.

Constitutional law --- Distribution of legislative powers — Relation between federal and provincial powers — Paramountcy of federal legislation — Miscellaneous

I Ltd. was part of group of companies that became insolvent — Bankruptcy protection was sought — I Ltd. was administrator of two registered pension plans — Salaried plan was in process of being wound up when Companies' Creditors Arrangement Act ("CCAA") proceedings began — Executive plan was closed but not wound up — Amended initial order was obtained, authorizing I Ltd. to borrow from debtor-in-possession ("DIP") lenders and granting them priority over all other creditors — Pension plan members brought unsuccessful motions for declaration that deemed trust equal to unfunded pension liability was enforceable against proceeds of sale of assets of I Ltd. — In allowing plan members' appeal, Court of Appeal ordered distribution from reserve fund in order to pay amount of each plan's deficiency — I Ltd., monitor, secured creditor, and trustee in bankruptcy appealed order — Appeal allowed — With respect to salaried plan, I Ltd. was deemed to hold in trust amount necessary to satisfy wind-up deficiency, but DIP charge superseded deemed trust by application of doctrine of federal paramountcy — Federal and provincial laws were inconsistent, as they gave rise to different, and conflicting, orders of priority — Section 30(7) of Personal Property Security Act required part of proceeds from asset sale to be paid to plan's administrator before other secured creditors were paid — However, amended initial order provided that DIP charge ranked in priority to all other security interests, trusts, liens, charges and encumbrances, statutory or otherwise — This court-ordered priority based on CCAA had same effect as statutory priority.

Bankruptcy and insolvency --- Practice and procedure in courts — Costs — Miscellaneous

I Ltd. was part of group of companies that became insolvent — Bankruptcy protection was sought — I Ltd. was administrator of two registered pension plans — Salaried plan was in process of being wound up when Companies' Creditors Arrangement Act proceedings began — Executive plan was closed but not wound up — Amended initial order was obtained, authorizing I Ltd. to borrow from debtor-in-possession lenders and granting them priority over all other creditors — Pension plan members brought unsuccessful motions for declaration that deemed trust equal to unfunded pension liability was enforceable against proceeds of sale of assets of I Ltd. — In allowing plan members' appeal, Court of Appeal ordered distribution from reserve fund in order to pay amount of each plan's deficiency — Court also issued costs endorsement that approved payment of costs of executive plan's members from that plan's fund, but declined to order payment of costs to union from fund of salaried plan — I Ltd., monitor, secured creditor, and trustee in bankruptcy appealed order, and union appealed costs endorsement — Appeal from order allowed; appeal from costs endorsement dismissed; Court of Appeal's orders with respect to costs of that appeal set aside, and all parties to bear their own costs in Court of Appeal and present appeal — There was no error in principle in Court of Appeal's refusal to order union costs to be paid out of pension fund, particularly in light of disposition of present appeal — Union's submissions as to costs were largely based on inaccurate reading of Court of Appeal's costs endorsement.

Pensions --- Practice in pension actions — Costs

I Ltd. was part of group of companies that became insolvent — Bankruptcy protection was sought — I Ltd. was administrator of two registered pension plans — Salaried plan was in process of being wound up when Companies' Creditors Arrangement Act proceedings began — Executive plan was closed but not wound up — Amended initial order was obtained, authorizing I Ltd. to borrow from debtor-in-possession lenders and granting them priority over all other creditors — Pension plan members brought unsuccessful motions for declaration that deemed trust equal to unfunded pension liability was enforceable against proceeds of sale of assets of I Ltd. — In allowing plan members' appeal, Court of Appeal ordered distribution from reserve fund in order to pay amount of each plan's deficiency — Court also issued costs endorsement that approved payment of costs of executive plan's members from that plan's fund, but declined to order payment of costs to union from fund of salaried plan — I Ltd., monitor, secured creditor, and trustee in bankruptcy appealed order, and union appealed costs endorsement — Appeal from order allowed; appeal from costs endorsement dismissed; Court of Appeal's orders with respect to costs of that appeal set aside, and all parties to bear their own costs in Court of Appeal and present appeal — There was no error in principle in Court of Appeal's refusal to order union costs to be paid out of pension fund, particularly in light of disposition of present appeal — Union's submissions as to costs were largely based on inaccurate reading of Court of Appeal's costs endorsement.

Pensions --- Payment of pension — Bankruptcy or insolvency of employer — Registered plans

Deficiency in plans' funding.

Pensions --- Administration of pension plans — Valuation and funding of plans — Deficiency

Insolvency of employer.

Civil practice and procedure --- Costs — Costs of appeals — Miscellaneous

Faillite et insolvabilité --- Biens du failli — Biens détenus en fiducie — Divers

Régimes de retraite — I Ltd. faisait partie d'un groupe de sociétés qui est devenu insolvable — Mesures de protection offertes en matière de faillite ont été déclenchées — I Ltd. administrait deux régimes de retraite enregistrés — Régime des salariés était en cours de liquidation lorsque les procédures sous le régime de la Loi sur les arrangements avec les créanciers des compagnies ont été engagées — Régime des cadres n'acceptait plus de participants, mais il n'était pas liquidé — Ordonnance initiale modifiée a été rendue autorisant I Ltd. à emprunter aux prêteurs au débiteur-exploitant (« DE ») et accordant à ces derniers une priorité sur tous les autres créanciers — Participants des régimes ont déposé des requêtes en vue d'obtenir un jugement déclaratoire portant que le produit de la vente des actifs de I Ltd. était grevé d'une fiducie présumée d'un montant équivalent au passif non capitalisé au titre des pensions — En accueillant l'appel interjeté par les participants, la Cour d'appel a ordonné de combler le déficit de chacun des régimes par prélèvement sur le fonds de réserve — I Ltd., le contrôleur, un créancier garanti et le syndic de faillite ont formé un pourvoi à l'encontre de l'ordonnance — Pourvoi accueilli — En ce qui concernait le régime des salariés, I Ltd. était présumée détenir en fiducie le montant nécessaire pour combler le déficit de liquidation — Fiducie présumée ne s'appliquait pas à un déficit de liquidation relativement au régime des cadres — Application de la doctrine de la prépondérance fédérale faisait en sorte que la sûreté accordée aux prêteurs DE avait priorité sur la fiducie présumée.

Faillite et insolvabilité --- Biens du failli — Fonds de pension

Fiducies — I Ltd. faisait partie d'un groupe de sociétés qui est devenu insolvable — Mesures de protection offertes en matière de faillite ont été déclenchées — I Ltd. administrait deux régimes de retraite enregistrés — Régime des salariés était en cours de liquidation lorsque les procédures sous le régime de la Loi sur les arrangements avec les créanciers des compagnies ont été engagées — Régime des cadres n'acceptait plus de participants, mais il n'était pas liquidé — Ordonnance initiale modifiée a été rendue autorisant I Ltd. à emprunter aux prêteurs au débiteur-exploitant (« DE ») et accordant à ces derniers une priorité sur tous les autres créanciers — Participants des régimes ont déposé des requêtes en vue d'obtenir un jugement déclaratoire portant que le produit de la vente des actifs de I Ltd. était grevé d'une fiducie présumée d'un montant équivalent au passif non capitalisé au titre des pensions — En accueillant l'appel interjeté par les participants, la Cour d'appel a ordonné de combler le déficit de chacun des régimes par prélèvement sur le fonds de réserve — I Ltd., le contrôleur, un créancier garanti et le syndic de faillite ont formé un pourvoi à l'encontre de l'ordonnance — Pourvoi accueilli — En ce qui concernait le régime des salariés, I Ltd. était présumée détenir en fiducie le montant nécessaire pour combler le déficit de liquidation — Fiducie présumée ne s'appliquait pas à un déficit de liquidation relativement au régime des cadres — Application de la doctrine de la prépondérance fédérale faisait en sorte que la sûreté accordée aux prêteurs DE avait priorité sur la fiducie présumée.

Régimes de retraite --- Administration des régimes de retraite — Administrateurs, fiduciaires et dépositaires — Obligations fiduciaires — Divers

I Ltd. faisait partie d'un groupe de sociétés qui est devenu insolvable — Mesures de protection offertes en matière de faillite ont été déclenchées — I Ltd. administrait deux régimes de retraite enregistrés — Régime des salariés était en cours de liquidation lorsque les procédures sous le régime de la Loi sur les arrangements avec les créanciers des compagnies ont été engagées — Régime des cadres n'acceptait plus de participants, mais il n'était pas liquidé — Ordonnance initiale modifiée a été rendue autorisant I Ltd. à emprunter aux prêteurs au débiteur-exploitant (« DE ») et accordant à ces derniers une priorité sur tous les autres créanciers — Participants des régimes ont déposé des requêtes en vue d'obtenir un jugement déclaratoire portant que le produit de la vente des actifs de I Ltd. était grevé d'une fiducie présumée d'un montant équivalent au passif non capitalisé au titre des pensions — En accueillant l'appel interjeté par les participants, la Cour d'appel a ordonné de combler le déficit de chacun des régimes par prélèvement sur le fonds de réserve — I Ltd., le contrôleur, un créancier garanti et le syndic de faillite ont formé un pourvoi à l'encontre de l'ordonnance — Pourvoi accueilli — Il y avait un conflit entre les obligations fiduciaires qui incombaient à I Ltd. en sa qualité d'administrateur des régimes et les décisions de gestion qu'elle devait prendre dans le meilleur intérêt de la société — I Ltd. aurait dû prendre des mesures pour assurer la protection des intérêts des participants au régime, mais ne l'a pas fait — En ce qui concernait le régime des salariés, I Ltd. était présumée détenir en fiducie le montant nécessaire pour combler le déficit de liquidation, mais en raison de la doctrine de la prépondérance fédérale, la sûreté accordée aux prêteurs DE avait priorité sur la fiducie présumée.

Régimes de retraite --- Administration des régimes de retraite — Administrateurs, fiduciaires et dépositaires — Obligations fiduciaires — Responsabilité découlant de la violation

I Ltd. faisait partie d'un groupe de sociétés qui est devenu insolvable — Mesures de protection offertes en matière de faillite ont été déclenchées — I Ltd. administrait deux régimes de retraite enregistrés — Régime des salariés était en cours de liquidation lorsque les procédures sous le régime de la Loi sur les arrangements avec les créanciers des compagnies ont été engagées — Régime des cadres n'acceptait plus de participants, mais il n'était pas liquidé — Ordonnance initiale modifiée a été rendue autorisant I Ltd. à emprunter aux prêteurs au débiteur-exploitant (« DE ») et accordant à ces derniers une priorité sur tous les autres créanciers — Participants des régimes ont déposé des requêtes en vue d'obtenir un jugement déclaratoire portant que le produit de la vente des actifs de I Ltd. était grevé d'une fiducie présumée d'un montant équivalent au passif non capitalisé au titre des pensions — En accueillant l'appel interjeté par les participants, la Cour d'appel a ordonné de combler le déficit de chacun des régimes par prélèvement sur le fonds de réserve — I Ltd., le contrôleur, un créancier garanti et le syndic de faillite ont formé un pourvoi à l'encontre de l'ordonnance — Pourvoi accueilli — Il y avait un conflit entre les obligations fiduciaires qui incombaient à I Ltd. en sa qualité d'administrateur des régimes et les décisions de gestion qu'elle devait prendre dans le meilleur intérêt de la société — I Ltd. aurait dû prendre des mesures pour assurer la protection des intérêts des participants au régime, mais ne l'a pas fait — Exigences permettant de reconnaître l'application d'une fiducie par interprétation à titre de mesure réparatrice n'étaient pas satisfaites — En ce qui concernait le régime des salariés, I Ltd. était présumée détenir en fiducie le montant nécessaire pour combler le déficit de liquidation, mais en raison de la doctrine de la prépondérance fédérale, la sûreté accordée aux prêteurs DE avait priorité sur la fiducie présumée.

Régimes de retraite --- Administration des régimes de retraite — Administrateurs, fiduciaires et dépositaires — Divers

I Ltd. faisait partie d'un groupe de sociétés qui est devenu insolvable — Mesures de protection offertes en matière de faillite ont été déclenchées — I Ltd. administrait deux régimes de retraite enregistrés — Régime des salariés était en cours de liquidation lorsque les procédures sous le régime de la Loi sur les arrangements avec les créanciers des compagnies ont été engagées — Régime des cadres n'acceptait plus de participants, mais il n'était pas liquidé — Ordonnance initiale modifiée a été rendue autorisant I Ltd. à emprunter aux prêteurs au débiteur-exploitant (« DE ») et accordant à ces derniers une priorité sur tous les autres créanciers — Participants des régimes ont déposé des requêtes en vue d'obtenir un jugement déclaratoire portant que le produit de la vente des actifs de I Ltd. était grevé d'une fiducie présumée d'un montant équivalent au passif non capitalisé au titre des pensions — En accueillant l'appel interjeté par les participants, la Cour d'appel a ordonné de combler le déficit de chacun des régimes par prélèvement sur le fonds de réserve — I Ltd., le contrôleur, un créancier garanti et le syndic de faillite ont formé un pourvoi à l'encontre de l'ordonnance — Pourvoi accueilli — Il y avait un conflit entre les obligations fiduciaires qui incombaient à I Ltd. en sa qualité d'administrateur des régimes et les décisions de gestion qu'elle devait prendre dans le meilleur intérêt de la société — I Ltd. aurait dû prendre des mesures pour assurer la protection des intérêts des participants au régime, mais ne l'a pas fait — En ce qui concernait le régime des salariés, I Ltd. était présumée détenir en fiducie le montant nécessaire pour combler le déficit de liquidation, mais en raison de la doctrine de la prépondérance fédérale, la sûreté accordée aux prêteurs DE avait priorité sur la fiducie présumée.

Faillite et insolvabilité --- Procédure devant les tribunaux — Appels — Divers

Règle interdisant les contestations indirectes — I Ltd. faisait partie d'un groupe de sociétés qui est devenu insolvable — Mesures de protection offertes en matière de faillite ont été déclenchées — I Ltd. administrait deux régimes de retraite enregistrés — Régime des salariés était en cours de liquidation lorsque les procédures sous le régime de la Loi sur les arrangements avec les créanciers des compagnies ont été engagées — Régime des cadres n'acceptait plus de participants, mais il n'était pas liquidé — Ordonnance initiale modifiée a été rendue autorisant I Ltd. à emprunter aux prêteurs au débiteur-exploitant (« DE ») et accordant à ces derniers une priorité sur tous les autres créanciers — Participants des régimes ont déposé des requêtes en vue d'obtenir un jugement déclaratoire portant que le produit de la vente des actifs de I Ltd. était grevé d'une fiducie présumée d'un montant équivalent au passif non capitalisé au titre des pensions — En accueillant l'appel interjeté par les participants, la Cour d'appel a ordonné de combler le déficit de chacun des régimes par prélèvement sur le fonds de réserve — I Ltd., le contrôleur, un créancier garanti et le syndic de faillite ont formé un pourvoi à l'encontre de l'ordonnance — Pourvoi accueilli — On ne pouvait pas affirmer que les participants au régme ne pouvaient pas défendre leurs intérêts en raison de la règle interdisant les contestations indirectes — Prétention selon laquelle les participants auraient dû interjeter appel de l'ordonnance initiale modifiée autorisant la charge DE et qu'ils ne devaient pas être admis à prétendre plus tard que leur créance avait priorité sur celle des prêteurs DE n'était pas convaincante — En ce qui concernait le régime des salariés, I Ltd.

était présumée détenir en fiducie le montant nécessaire pour combler le déficit de liquidation, mais en raison de la doctrine de la prépondérance fédérale, la sûreté accordée aux prêteurs DE avait priorité sur la fiducie présumée.

Faillite et insolvabilité --- Administration de l'actif — Vente des actifs — Divers

Partage du produit de la vente — I Ltd. faisait partie d'un groupe de sociétés qui est devenu insolvable — Mesures de protection offertes en matière de faillite ont été déclenchées — I Ltd. administrait deux régimes de retraite enregistrés — Régime des salariés était en cours de liquidation lorsque les procédures sous le régime de la Loi sur les arrangements avec les créanciers des compagnies ont été engagées — Régime des cadres n'acceptait plus de participants, mais il n'était pas liquidé — Ordonnance initiale modifiée a été rendue autorisant I Ltd. à emprunter aux prêteurs au débiteur-exploitant (« DE ») et accordant à ces derniers une priorité sur tous les autres créanciers — Participants des régimes ont déposé des requêtes en vue d'obtenir un jugement déclaratoire portant que le produit de la vente des actifs de I Ltd. était grevé d'une fiducie présumée d'un montant équivalent au passif non capitalisé au titre des pensions — En accueillant l'appel interjeté par les participants, la Cour d'appel a ordonné de combler le déficit de chacun des régimes par prélèvement sur le fonds de réserve — I Ltd., le contrôleur, un créancier garanti et le syndic de faillite ont formé un pourvoi à l'encontre de l'ordonnance — Pourvoi accueilli — En ce qui concernait le régime des salariés, I Ltd. était présumée détenir en fiducie le montant nécessaire pour combler le déficit de liquidation — Fiducie présumée ne s'appliquait pas à un déficit de liquidation relativement au régime des cadres — Application de la doctrine de la prépondérance fédérale faisait en sorte que la sûreté accordée aux prêteurs DE avait priorité sur la fiducie présumée.

Sûretés mobilières --- Ordre de priorité de la sûreté — Sûreté par rapport à d'autres intérêts — En vertu de la législation provinciale — Fiducies d'origine législative et présumées

Loi sur les arrangements avec les créanciers des compagnies — I Ltd. faisait partie d'un groupe de sociétés qui est devenu insolvable — Mesures de protection offertes en matière de faillite ont été déclenchées — I Ltd. administrait deux régimes de retraite enregistrés — Régime des salariés était en cours de liquidation lorsque les procédures sous le régime de la Loi sur les arrangements avec les créanciers des compagnies ont été engagées — Régime des cadres n'acceptait plus de participants, mais il n'était pas liquidé — Ordonnance initiale modifiée a été rendue autorisant I Ltd. à emprunter aux prêteurs au débiteur-exploitant (« DE ») et accordant à ces derniers une priorité sur tous les autres créanciers — Participants des régimes ont déposé des requêtes en vue d'obtenir un jugement déclaratoire portant que le produit de la vente des actifs de I Ltd. était grevé d'une fiducie présumée d'un montant équivalent au passif non capitalisé au titre des pensions — En accueillant l'appel interjeté par les participants, la Cour d'appel a ordonné de combler le déficit de chacun des régimes par prélèvement sur le fonds de réserve — I Ltd., le contrôleur, un créancier garanti et le syndic de faillite ont formé un pourvoi à l'encontre de l'ordonnance — Pourvoi accueilli — En ce qui concernait le régime des salariés, I Ltd. était présumée détenir en fiducie le montant nécessaire pour combler le déficit de liquidation — Fiducie présumée ne s'appliquait pas à un déficit de liquidation relativement au régime des cadres — Application de la doctrine de la prépondérance fédérale faisait en sorte que la sûreté accordée aux prêteurs DE avait priorité sur la fiducie présumée.

Faillite et insolvabilité --- Priorité des créances — Réclamations privilégiées — Traitements et salaires des employés — Création d'une fiducie par la loi

Régimes de retraite — I Ltd. faisait partie d'un groupe de sociétés qui est devenu insolvable — Mesures de protection offertes en matière de faillite ont été déclenchées — I Ltd. administrait deux régimes de retraite enregistrés — Régime des salariés était en cours de liquidation lorsque les procédures sous le régime de la Loi sur les arrangements avec les créanciers des compagnies ont été engagées — Régime des cadres n'acceptait plus de participants, mais il n'était pas liquidé — Ordonnance initiale modifiée a été rendue autorisant I Ltd. à emprunter aux prêteurs au débiteur-exploitant (« DE ») et accordant à ces derniers une priorité sur tous les autres créanciers — Participants des régimes ont déposé des requêtes en vue d'obtenir un jugement déclaratoire portant que le produit de la vente des actifs de I Ltd. était grevé d'une fiducie présumée d'un montant équivalent au passif non capitalisé au titre des pensions — En accueillant l'appel interjeté par les participants, la Cour d'appel a ordonné de combler le déficit de chacun des régimes par prélèvement sur le fonds de réserve — I Ltd., le contrôleur, un créancier garanti et le syndic de faillite ont formé un pourvoi à l'encontre de l'ordonnance — Pourvoi accueilli — En ce qui concernait le régime des salariés, I Ltd. était présumée détenir en fiducie le montant nécessaire pour combler le déficit de liquidation — Fiducie présumée ne s'appliquait pas à un déficit de liquidation relativement au régime des cadres — Application de la doctrine de la prépondérance fédérale faisait en sorte que la sûreté accordée aux prêteurs DE avait priorité sur la fiducie présumée.

Faillite et insolvabilité --- Compétence en matière de faillite et d'insolvabilité — Compétence constitutionnelle du gouvernement fédéral et des provinces — Prépondérance de la compétence fédérale

I Ltd. faisait partie d'un groupe de sociétés qui est devenu insolvable — Mesures de protection offertes en matière de faillite ont été déclenchées — I Ltd. administrait deux régimes de retraite enregistrés — Régime des salariés était en cours de liquidation lorsque les procédures sous le régime de la Loi sur les arrangements avec les créanciers de compagnies (« LACC ») ont été engagées — Régime des cadres n'acceptait plus de participants, mais il n'était pas liquidé — Ordonnance initiale modifiée a été rendue autorisant I Ltd. à emprunter aux prêteurs au débiteur-exploitant (« DE ») et accordant à ces derniers une priorité sur tous les autres créanciers — Participants des régimes ont déposé des requêtes en vue d'obtenir un jugement déclaratoire portant que le produit de la vente des actifs de I Ltd. était grevé d'une fiducie présumée d'un montant équivalent au passif non capitalisé au titre des pensions — En accueillant l'appel interjeté par les participants, la Cour d'appel a ordonné de combler le déficit de chacun des régimes par prélèvement sur le fonds de réserve — I Ltd., le contrôleur, un créancier garanti et le syndic de faillite ont formé un pourvoi à l'encontre de l'ordonnance — Pourvoi accueilli — En ce qui concernait le régime des salariés, I Ltd. était présumée détenir en fiducie le montant nécessaire pour combler le déficit de liquidation, mais en raison de la doctrine de la prépondérance fédérale, la sûreté accordée aux prêteurs DE avait priorité sur la fiducie présumée — Dispositions fédérales et provinciales étaient inconciliables, car elles produisaient des ordres de priorité différents et conflictuels — Article 30(7) de la Loi sur les sûretés mobilières exigeait qu'une partie du produit de la vente soit versée à l'administrateur du régime de retraite par priorité sur les paiements aux autres créanciers garantis — Or, l'ordonnance initiale amendée prévoyait que la sûreté accordée aux prêteurs DE prenait rang devant toutes les autres sûretés, y compris les fiducies, privilèges, charges et grèvements, d'origine législative ou autre — Cette priorité d'origine judiciaire fondée sur la LACC avait le même effet qu'une priorité d'origine législative.

Successions et fiducies --- Fiducies — Fiducie par interprétation — Profits des fiduciaires

Manquement à l'obligation fiduciaire — I Ltd. faisait partie d'un groupe de sociétés qui est devenu insolvable — Mesures de protection offertes en matière de faillite ont été déclenchées — I Ltd. administrait deux régimes de retraite enregistrés — Régime des salariés était en cours de liquidation lorsque les procédures sous le régime de la Loi sur les arrangements avec les créanciers de compagnies ont été engagées — Régime des cadres n'acceptait plus de participants, mais il n'était pas liquidé — Ordonnance initiale modifiée a été rendue autorisant I Ltd. à emprunter aux prêteurs au débiteur-exploitant (« DE ») et accordant à ces derniers une priorité sur tous les autres créanciers — Participants des régimes ont déposé des requêtes en vue d'obtenir un jugement déclaratoire portant que le produit de la vente des actifs de I Ltd. était grevé d'une fiducie présumée d'un montant équivalent au passif non capitalisé au titre des pensions — En accueillant l'appel interjeté par les participants, la Cour d'appel a ordonné de combler le déficit de chacun des régimes par prélèvement sur le fonds de réserve — I Ltd., le contrôleur, un créancier garanti et le syndic de faillite ont formé un pourvoi à l'encontre de l'ordonnance — Pourvoi accueilli — Il y avait un conflit entre les obligations fiduciaires qui incombaient à I Ltd. en sa qualité d'administrateur des régimes et les décisions de gestion qu'elle devait prendre dans le meilleur intérêt de la société — I Ltd. aurait dû prendre des mesures pour assurer la protection des intérêts des participants au régime, mais ne l'a pas fait — Exigences permettant de reconnaître l'application d'une fiducie par interprétation à titre de mesure réparatrice n'étaient pas satisfaites — En ce qui concernait le régime des salariés, I Ltd. était présumée détenir en fiducie le montant nécessaire pour combler le déficit de liquidation, mais en raison de la doctrine de la prépondérance fédérale, la sûreté accordée aux prêteurs DE avait priorité sur la fiducie présumée.

Droit constitutionnel --- Partage des compétences législatives — Rapport entre les compétences fédérales et compétences provinciales — Prépondérance des lois fédérales — Divers

I Ltd. faisait partie d'un groupe de sociétés qui est devenu insolvable — Mesures de protection offertes en matière de faillite ont été déclenchées — I Ltd. administrait deux régimes de retraite enregistrés — Régime des salariés était en cours de liquidation lorsque les procédures sous le régime de la Loi sur les arrangements avec les créanciers de compagnies (« LACC ») ont été engagées — Régime des cadres n'acceptait plus de participants, mais il n'était pas liquidé — Ordonnance initiale modifiée a été rendue autorisant I Ltd. à emprunter aux prêteurs au débiteur-exploitant (« DE ») et accordant à ces derniers une priorité sur tous les autres créanciers — Participants des régimes ont déposé des requêtes en vue d'obtenir un jugement déclaratoire portant que le produit de la vente des actifs de I Ltd. était grevé d'une fiducie présumée d'un montant équivalent au passif non capitalisé au titre des pensions — En accueillant l'appel interjeté par les participants, la Cour d'appel a ordonné de combler le déficit de chacun des régimes par prélèvement sur le fonds de réserve — I Ltd., le contrôleur, un créancier garanti et le syndic de faillite ont formé un pourvoi à l'encontre de l'ordonnance — Pourvoi accueilli — En ce qui concernait le régime des salariés, I Ltd. était présumée détenir en fiducie le montant nécessaire pour combler le déficit de liquidation, mais en raison de la doctrine de la prépondérance fédérale, la sûreté accordée aux prêteurs DE avait priorité sur la fiducie présumée — Dispositions fédérales et provinciales étaient inconciliables, car elles produisaient des ordres de priorité différents et conflictuels — Article 30(7) de la Loi sur les sûretés mobilières exigeait qu'une partie du produit de la vente soit versée à l'administrateur du régime de retraite par priorité sur les paiements aux autres créanciers garantis — Or, l'ordonnance initiale amendée prévoyait que la sûreté accordée aux prêteurs DE prenait rang devant toutes les autres sûretés, y compris les fiducies, privilèges, charges et grèvements, d'origine législative ou autre — Cette priorité d'origine judiciaire fondée sur la LACC avait le même effet qu'une priorité d'origine législative.

Faillite et insolvabilité --- Procédure devant les tribunaux — Frais — Divers

I Ltd. faisait partie d'un groupe de sociétés qui est devenu insolvable — Mesures de protection offertes en matière de faillite ont été déclenchées — I Ltd. administrait deux régimes de retraite enregistrés — Régime des salariés était en cours de liquidation lorsque les procédures sous le régime de la Loi sur les arrangements avec les créanciers de compagnies ont été engagées — Régime des cadres n'acceptait plus de participants, mais il n'était pas liquidé — Ordonnance initiale modifiée a été rendue autorisant I Ltd. à emprunter aux prêteurs au débiteur-exploitant et accordant à ces derniers une priorité sur tous les autres créanciers — Participants des régimes ont déposé des requêtes en vue d'obtenir un jugement déclaratoire portant que le produit de la vente des actifs de I Ltd. était grevé d'une fiducie présumée d'un montant équivalent au passif non capitalisé au titre des pensions — En accueillant l'appel interjeté par les participants, la Cour d'appel a ordonné de combler le déficit de chacun des régimes par prélèvement sur le fonds de réserve — Cour a également rendu une décision concernant les frais qui approuvait le paiement des dépens des participants au régime des cadres sur leur caisse de retraite, mais a refusé d'ordonner que les dépens du syndicat soient acquittés sur la caisse de retraite du régime des salariés — I Ltd., le contrôleur, un créancier garanti et le syndic de faillite ont formé un pourvoi à l'encontre de l'ordonnance, et le syndicat a interjeté appel à l'encontre de la décision concernant les frais — Pourvoi à l'encontre de l'ordonnance accueilli; pourvoi à l'encontre de l'adjudication des dépens rejeté; ordonnances de la Cour d'appel relatives aux dépens afférents aux appels interjetés devant elle annulées, et il a été ordonné que chacune des parties paie ses propres dépens devant la Cour d'appel et devant la Cour suprême du Canada — Décision de la Cour d'appel de refuser d'ordonner que les frais du syndicat soient acquittés sur la caisse de retraite n'était entachée d'aucune erreur de principe, surtout considérant l'issue du présent pourvoi — Prétentions du syndicat relativement aux frais reposaient en grande partie sur une interprétation erronée de la décision de la Cour d'appel concernant les frais.

Régimes de retraite --- Procédure dans le cadre d'actions concernant des régimes de retraite — Frais

I Ltd. faisait partie d'un groupe de sociétés qui est devenu insolvable — Mesures de protection offertes en matière de faillite ont été déclenchées — I Ltd. administrait deux régimes de retraite enregistrés — Régime des salariés était en cours de liquidation lorsque les procédures sous le régime de la Loi sur les arrangements avec les créanciers de compagnies (« LACC ») ont été engagées — Régime des cadres n'acceptait plus de participants, mais il n'était pas liquidé — Ordonnance initiale modifiée a été rendue autorisant I Ltd. à emprunter aux prêteurs au débiteur-exploitant et accordant à ces derniers une priorité sur tous les autres créanciers — Participants des régimes ont déposé des requêtes en vue d'obtenir un jugement déclaratoire portant que le produit de la vente des actifs de I Ltd. était grevé d'une fiducie présumée d'un montant équivalent au passif non capitalisé au titre des pensions — En accueillant l'appel interjeté par les participants, la Cour d'appel a ordonné de combler le déficit de chacun des régimes par prélèvement sur le fonds de réserve — Cour a également rendu une décision concernant les frais qui approuvait le paiement des dépens des participants au régime des cadres sur leur caisse de retraite mais a refusé d'ordonner que les dépens du syndicat soient acquittés sur la caisse de retraite du régime des salariés — I Ltd., le contrôleur, un créancier garanti et le syndic de faillite ont formé un pourvoi à l'encontre de l'ordonnance, et le syndicat a interjeté appel à l'encontre de la décision concernant les frais — Pourvoi à l'encontre de l'ordonnance accueilli; pourvoi à l'encontre de l'adjudication des dépens rejeté; ordonnances de la Cour d'appel relatives aux dépens afférents aux appels interjetés devant elle annulées, et il a été ordonné que chacune des parties paie ses propres dépens devant la Cour d'appel et devant la Cour suprême du Canada — Décision de la Cour d'appel de refuser d'ordonner que les frais du syndicat soient acquittés sur la caisse de retraite n'était entachée d'aucune erreur de principe, surtout considérant l'issue du présent pourvoi — Prétentions du syndicat relativement aux frais reposaient en grande partie sur une interprétation erronée de la décision de la Cour d'appel concernant les frais.

Régimes de retraite --- Paiement de la rente — Faillite ou insolvabilité de l'employeur — Régimes enregistrés

Déficit dans le financement des régimes.

Régimes de retraite --- Administration des régimes de retraite — Évaluation et financement des régimes — Déficit

Insolvabilité de l'employeur.

Procédure civile --- Frais — Frais d'appel — Divers

I Ltd. was a Canadian subsidiary of I Corp. U.S. The I Ltd. group became insolvent. I Corp. U.S. sought bankruptcy protection. I Ltd. obtained a stay under the Companies' Creditors Arrangement Act ("CCAA"). I Ltd. was the administrator of two registered pension plans. The salaried plan was in the process of being wound up when the CCAA proceedings began. The executive plan was closed but not wound up. Protection under the CCAA was obtained, and both plans faced funding deficiencies. An amended initial order was obtained, authorizing I Ltd. to borrow from debtor-in-possession ("DIP") lenders and granting them priority over all other creditors. I Ltd. sold its assets. Plan members brought motions for a declaration that a deemed trust equal in amount to the unfunded pension liability was enforceable against the proceeds of sale.

In dismissing the motions, the court found that the deemed trust did not apply to the wind-up deficiencies, because the associated payments were not "due" or "accruing due" as of the date of the wind-up. The court found that the executive plan did not have a wind-up deficiency, since it had not yet been wound up. The plan members appealed successfully. The Court of Appeal found that the deemed trust created by s. 57(4) of the Pension Benefits Act ("PBA") applied to all amounts due with respect to plan wind-up deficiencies. The Court of Appeal found that executive plan members had a claim arising from I Ltd.'s breach of fiduciary obligations in failing to adequately protect plan members' interests. The Court of Appeal found that imposing a constructive trust over the reserved fund in favour of plan members was an appropriate remedy. The Court of Appeal found that the deemed trust had priority over the DIP charge because the issue of federal paramountcy had not been raised when the amended initial order was issued, and that I Ltd. had stated that it intended to comply with any deemed trust requirements. The Court of appeal ordered the court-appointed monitor to make a distribution from the reserve fund in order to pay the amount of each plan's deficiency. It also issued a costs endorsement that approved payment of the costs of the executive plan's members from that plan's fund, but declined to order the payment of costs to the union from the fund of the salaried plan. I Ltd., the monitor, a secured creditor, and I Corp. U.S.'s trustee in bankruptcy appealed the main order, and the union appealed the costs endorsement.

Held: The appeal of the main order was allowed, and the union's appeal of the costs endorsement was dismissed. The Court of Appeal's orders with respect to the costs of appeal before that court were set aside, and it was ordered that all parties bear their own costs in the Court of Appeal and in the Supreme Court of Canada.

Per Deschamps J. (Moldaver J. concurring): The Court of Appeal correctly held with respect to the salaried plan, which had been wound up, that I Ltd. was deemed to hold in trust the amount necessary to satisfy the wind-up deficiency. The relevant provisions, legislative history and purpose were all consistent with inclusion of the wind-up deficiency in the protection afforded to members with respect to employer contributions upon the wind up of their pension plan. The deemed trust did not apply to the employer's wind-up deficiency with respect to the executive plan. Unlike s. 57(3) of the PBA, which provides that the deemed trust protecting employer contributions exists while a plan is ongoing, s. 57(4) provides that the wind-up deemed trust comes into existence only when the plan is wound up.

As a result of the application of the doctrine of federal paramountcy, the DIP charge superseded the deemed trust. Subject to the application of the rules on the admissibility of new evidence, the doctrine of paramountcy could be raised even if it was not invoked in an initial proceeding. The federal and provincial laws in this case were inconsistent, as they gave rise to different, and conflicting, orders of priority. Section 30(7) of the (provincial) Personal Property Security Act required a part of the proceeds from the sale to be paid to the plan's administrator before other secured creditors were paid. However, the amended initial order provided that the DIP charge ranked in priority to all other security interests, trusts, liens, charges and encumbrances, statutory or otherwise. This court-ordered priority based on the (federal) CCAA had the same effect as a statutory priority.

I Ltd.'s fiduciary obligations as plan administrator conflicted with management decisions that needed to be taken in the best interests of the corporation. The fact that I Ltd., as plan administrator, might have to claim accrued contributions from itself meant that it would have to simultaneously adopt conflicting positions on whether contributions had accrued as of the date of liquidation and whether a deemed trust had arisen in respect of wind-up deficiencies. This was indicative of a clear conflict between I Ltd.'s interests and those of the plan members. I Ltd. should have taken steps to ensure that the interests of the plan members were protected, but did not do so. On the contrary, it contested the position that the plan members advanced.

It could not be argued that the plan members were barred from defending their interests by the collateral attack doctrine. The argument that the plan members should have appealed the amended initial order authorizing the DIP charge, and were precluded from subsequently arguing that their claim ranked in priority to that of the DIP lenders, was not convincing. Among other things, the plan members did not receive notice of the motion to approve the DIP financing.

Even though I Ltd. breached its fiduciary duty to notify the plan members of the motion that resulted in the amended initial order, their claim remained subordinate to that of I Corp. U.S. (subrogated, as I Corp. U.S. was, to the DIP lenders' priority). In terms of an equitable remedy, there was no evidence that the lenders committed a wrong or that they engaged in inequitable conduct. The constructive trust remedy was not available, because proprietary remedies are generally awarded only with respect to property that is directly related to a wrong or that can be traced to such property. There was agreement with Cromwell J. that this condition was not met. It was unreasonable for the Court of Appeal to re-order the priorities in this case. It was difficult to see what gains the plan members would have secured had they received notice of the motion that resulted in the amended initial order. The plan members were allowed to fully argue their case.

There was agreement with Cromwell J. on the appeal from the costs endorsement.

Per Cromwell J. (concurring in the result) (McLachlin C.J.C., Rothstein J. concurring): The deemed trust did not apply to the disputed funds. The Court of Appeal erred in finding that the s. 57(4) (PBA) deemed trust applied to the wind-up deficiency. There could be no deemed trust for the executive plan, because the plan had not been wound up at the relevant date. At issue was the salaried plan. The most plausible grammatical and ordinary sense of the words "accrued to the date of the wind-up" was that the amounts referred to were precisely ascertained immediately before the effective date of the plan's wind-up. The wind-up deficiency only arose upon wind-up and it was neither ascertained nor ascertainable on the date fixed for wind-up. The broader statutory context reinforced this view: the language of the deemed trusts in s. 57(3) and (4) was virtually exactly repeated in s. 75(1)(a), suggesting that both deemed trusts referred to the liability on wind-up referred to in s. 75(1)(a) and not to the further and distinct wind-up deficiency liability created under s. 75(1)(b). The legislative evolution and history of these provisions showed that the legislature never intended to include the wind-up deficiency in a statutory deemed trust. There was disagreement with Deschamps J.'s position that the wind-up deficiency could be said to have accrued to the date of wind-up.

The corporation failed in its duty to the plan beneficiaries as their administrator, and the beneficiaries ought to have been afforded more procedural protections in the CCAA proceedings. The Court of Appeal took too expansive a view of the fiduciary duties owed by I Ltd. as plan administrator. The only breach of fiduciary duty occurred when, upon insolvency, I Ltd.'s corporate interests were in obvious conflict with its fiduciary duty as plan administrator to ensure that all contributions were made to the plans when due. The breach was not in failing to avoid this conflict — the conflict itself was unavoidable. The breach was in failing to address the conflict to ensure that the plan beneficiaries had the opportunity to have representation in the CCAA proceedings as if there were independent plan administrators.

The Court of Appeal erred in using the equitable remedy of constructive trust to defeat the super priority ordered by the CCAA judge. The Court of Appeal erred in principle in finding that the asset in this case resulted from the breach of fiduciary duty such that it would be unjust for the party in breach to retain it. I Ltd.'s failure to meaningfully address conflicts of interest that arose during the CCAA proceedings did not result in any such asset. Imposing a constructive trust was wholly disproportionate to I Ltd.'s breach of fiduciary duty.

Although there was disagreement with Deschamps J. with respect to the scope of the s. 57(4) deemed trust, there was agreement that if there was a deemed trust in this case, it would have been superseded by the DIP loan because of the operation of the doctrine of federal paramountcy.

The union's submissions as to costs were largely based on an inaccurate reading of the Court of Appeal's costs endorsement. The Court of Appeal did not require the consent of plan beneficiaries as a prerequisite to ordering payment of costs from the fund. It was not correct to suggest that the costs endorsement would restrict recovery of beneficiary costs to instances when there is a surplus in the pension trust fund or preclude financing of beneficiary action when a fund was in deficit. The costs endorsement did not lay down a rule that a union representing pension beneficiaries cannot recover costs from the fund because the union itself is not a beneficiary. The litigation raised novel points of law with all of the uncertainty and risk inherent in such an undertaking. The failure of that litigation left no basis to impose the costs consequences of taking the risk on all of the plan members of an already underfunded plan. The union's apparent premise that if the executive plan members had their costs paid out of the fund, so too should the salaried plan members, was not an accurate statement of the order made with respect to the executive plan. The Court of Appeal did not apply what the union referred to as the "costs payment test" to the executive plan because the costs order was the product of an agreement and did not order payment of costs out of the fund as a whole. In the case of the union request, there was no such agreement and no such limitation of risk to the supporters of the litigation. There was no error in principle in the Court of Appeal's refusal to order the union costs to be paid out of the pension fund, particularly in light of the disposition of the present appeal.

Per LeBel J. (dissenting) (Abella J. concurring): There was agreement that no deemed trust could arise under s. 57(4) of the PBA in the case of the executive plan because that plan had not been wound up when the CCAA proceedings were initiated. In the case of the salaried plan, there was agreement with Deschamps J. that a deemed trust arose in respect of the wind-up deficiency, but also that the DIP super-priority prevailed because of the federal paramountcy doctrine.

However, the remedy of a constructive trust was available and it was appropriate to impose it in the circumstances of this case. A view different from that of the majority in the present decision was taken with regard to the nature and extent of the fiduciary duties of an employer who elects to act as administrator of a pension plan governed by the PBA. This dual status did not entitle the employer to greater leniency in the determination and exercise of its fiduciary duties or excuse wrongful actions. I Ltd. not only neglected its obligations towards the beneficiaries, but took a course of action that was actively inimical to their interests. The seriousness of these breaches amply justified the decision of the Court of Appeal to impose a constructive trust. The conditions that generally justify the imposition of a constructive trust were met. The imposition of the trust did not disregard the different corporate personalities of I Ltd. and I Corp. U.S. It properly acknowledged the close relationship between the two companies, the second in effect controlling the first. This relationship needed to be taken into consideration.

I Ltd. était une filiale canadienne de la société I É.-U. Le groupe I Ltd. est devenu insolvable. I É.-U. s'est placée sous la protection des règles applicables en matière de faillite. I Ltd. a obtenu une ordonnance de suspension sous le régime de la Loi sur les arrangements avec les créanciers des compagnies (« LACC »). I Ltd. administrait deux régimes de retraite enregistrés. Le régime des salariés était en cours de liquidation lorsque les procédures sous le régime de la LACC ont été engagées. Le régime des cadres n'acceptait plus de participants, mais il n'était pas liquidé. La protection du régime de la LACC a été accordée, et les deux régimes de retraite accusaient un déficit de capitalisation. Une ordonnance initiale modifiée a été rendue autorisant I Ltd. à emprunter aux prêteurs au débiteur-exploitant (« DE ») et accordant à ces derniers une priorité sur tous les autres créanciers. I Ltd. a vendu tous ses actifs. Les participants des régimes ont déposé des requêtes en vue d'obtenir un jugement déclaratoire portant que le produit de la vente était grevé d'une fiducie présumée d'un montant équivalent au passif non capitalisé au titre des pensions.

En rejetant les requêtes, le tribunal a conclu que la fiducie présumée ne s'appliquait pas aux déficits de liquidation parce que les paiements afférents n'étaient pas [TRADUCTION] « échus » ou « à échoir » à la date de la liquidation. Le tribunal a conclu que l'on ne pouvait pas parler de déficit de liquidation relativement au régime des cadres puisqu'il n'était pas encore liquidé. Les participants des régimes ont interjeté appel avec succès. La Cour d'appel a conclu que la fiducie présumée créée à l'art. 57(4) de la Loi sur les régimes de retraite (« LRR ») s'appliquait à toutes les sommes dues au titre des déficits de liquidation des régimes. La Cour d'appel a conclu que les participants au régime des cadres pouvaient faire valoir une réclamation contre I Ltd. pour manquement à son obligation fiduciaire de protéger adéquatement leurs intérêts. La Cour d'appel a jugé que d'imposer une fiducie par interprétation grevant le fonds de réserve au profit des participants était une réparation appropriée. La Cour d'appel a conclu que la fiducie présumée avait priorité sur la charge DE parce que la question de la prépondérance fédérale n'avait pas été invoquée lorsque l'ordonnance initiale modifiée a été rendue et qu'I Ltd. avait déclaré qu'elle allait se conformer à toutes les exigences d'une fiducie présumée. La Cour d'appel a ordonné au contrôleur désigné par le tribunal de combler le déficit de chacun des régimes par prélèvement sur le fonds de réserve. Dans sa décision relative à l'adjudication des dépens, elle a également approuvé le paiement des dépens des participants au régime des cadres sur leur caisse de retraite, mais elle a refusé d'ordonner que les dépens du syndicat soient acquittés sur la caisse de retraite du régime des salariés. I Ltd., le contrôleur, un créancier garanti et le syndic de faillite d'I É.-U. ont formé un pourvoi à l'encontre de l'ordonnance principale et le syndicat a formé un pourvoi à l'encontre de l'adjudication des dépens.

Arrêt: Le pourvoi à l'encontre de l'ordonnance principale a été accueillie et le pourvoi du syndicat à l'encontre de l'adjudication des dépens a été rejeté. Les ordonnances de la Cour d'appel relatives aux dépens afférents aux appels interjetés devant elle ont été annulées et il a été ordonné que chacune des parties paie ses propres dépens devant la Cour d'appel et devant la Cour suprême du Canada.

Deschamps, J. (Moldaver, J., souscrivant à son opinion) : C'était à bon droit que la Cour d'appel a jugé qu'I Ltd. était présumée détenir en fiducie le montant nécessaire pour combler le déficit de liquidation du régime des salariés, dont la liquidation avait pris effet. Le texte, l'historique législatif et l'objet des dispositions pertinentes concordaient tous avec l'inclusion du déficit de liquidation dans la protection offerte aux participants à l'égard des cotisations de l'employeur à la liquidation des régimes. La fiducie présumée ne s'appliquait pas au déficit de liquidation de l'employeur relativement au régime des cadres. Contrairement à l'art. 57(3) de la LRR, selon lequel la fiducie présumée protégeant les cotisations de l'employeur existe pendant que le régime est en vigueur, l'art. 57(4) prévoit que la fiducie présumée en cas de liquidation ne prend naissance qu'à la liquidation du régime.

L'application de la doctrine de la prépondérance fédérale donnait à la charge DE priorité sur la fiducie présumée. Sous réserve de l'application des règles régissant l'admissibilité de nouveaux éléments de preuve, la doctrine de la prépondérance fédérale pouvait être soulevée même si elle n'avait pas été invoquée dans une procédure initiale. En l'espèce, les dispositions fédérales et provinciales étaient inconciliables, car elles produisaient des ordres de priorité différents et conflictuels. L'article 30(7) de la Loi sur les sûretés mobilières (provinciale) exigeait qu'une partie du produit de la vente soit versée à l'administrateur du régime de retraite par priorité sur les paiements aux autres créanciers garantis. Toutefois, l'ordonnance initiale modifiée accordait à la charge DE priorité sur toutes les autres sûretés, y compris les fiducies, privilèges, charges et grèvements, d'origine législative ou autre. Cette priorité d'origine judiciaire fondée sur la LACC (fédérale) avait le même effet qu'une priorité d'origine législative.

Il y avait un conflit entre les obligations fiduciaires qui incombaient à I Ltd. en sa qualité d'administrateur des régimes et les décisions de gestion qu'elle devait prendre dans le meilleur intérêt de la société. Le fait qu'I Ltd. pouvait, en sa qualité d'administrateur des régimes de retraite, avoir à se réclamer à elle-même les cotisations accumulées l'amènerait à devoir adopter simultanément des positions opposées quant à savoir si des cotisations s'étaient accumulées à la date de la liquidation et si les déficits de capitalisation étaient protégés par une fiducie présumée. Cet exemple démontrait qu'il existait manifestement un conflit entre les intérêts d'I Ltd. et ceux des participants au régime. I Ltd. aurait dû prendre des mesures pour assurer la protection des intérêts des participants au régime, mais ne l'a pas fait. Elle a, au contraire, contesté la position défendue par les participants au régime.

La règle interdisant les contestations indirectes ne pouvait donc être invoquée pour empêcher les participants de défendre leurs intérêts. La prétention selon laquelle les participants auraient dû interjeter appel de l'ordonnance initiale modifiée autorisant la charge DE et qu'ils ne devaient pas être admis à prétendre plus tard que leur créance avait priorité sur celle des prêteurs DE n'était pas convaincante. Entre autres choses, les participants n'ont pas reçu avis de la requête demandant au tribunal d'autoriser le financement DE.

Bien qu'I Ltd. ait manqué à son obligation fiduciaire d'informer les participants de la requête en modification de l'ordonnance initiale, leur créance demeurait subordonnée à celle d'I É.-U. (I É.-U. étant subrogée aux prêteurs DE en conséquence de la priorité). À propos d'une réparation en equity, la preuve ne révélait aucune inconduite ni injustice de la part des prêteurs. La fiducie par interprétation n'était pas une réparation que l'on pouvait imposer, car la réparation de la nature d'un droit de propriété n'était généralement accordée qu'à l'égard d'un bien ayant un lien direct avec un acte fautif ou d'un bien qui pouvait être rattaché à un tel bien. On partageait l'avis du juge Cromwell que cette condition n'était pas remplie. Il était déraisonnable pour la Cour d'appel de modifier l'ordre de priorité en l'espèce. Il était difficile de voir comment les participants auraient pu améliorer leur position même s'ils avaient reçu avis de la requête en modification de l'ordonnance initiale. Les participants ont pu faire valoir pleinement leur position.

On convenait avec le juge Cromwell au sujet de l'adjudication des dépens.

Cromwell, J. (souscrivant au résultat des juges majoritaires) (McLachlin, J.C.C., Rothstein, J., souscrivant à son opinion) : La fiducie présumée ne visait pas les fonds en cause. La Cour d'appel a commis une erreur en concluant que la fiducie présumée prévue à l'art. 57(4) de la LRR s'appliquait au déficit de liquidation. Il ne pouvait y avoir de fiducie présumée au bénéfice du régime des cadres, car celui-ci n'avait pas encore été liquidé à la date considérée. Le litige ne portait que sur le régime des salariés. Suivant son sens ordinaire et grammatical le plus plausible, l'expression « accumulées à la date de la liquidation » renvoyait aux sommes déterminées de façon précise immédiatement avant la date de prise d'effet de la liquidation du régime. Le déficit de liquidation n'était constaté qu'à l'issue de la liquidation, et il n'était ni déterminé ni déterminable à la date de liquidation prévue. Le contexte législatif général confortait ce point de vue. Le texte de l'art. 57(3) et (4) qui dispose qu'il y a fiducie présumée est repris presque en tous points à l'art. 75(1)a), ce qui permettait de conclure que, dans les deux cas de fiducie présumée, le législateur renvoyait à l'obligation qui existait à la liquidation suivant l'art. 75(1)a) et non à celle, supplémentaire et distincte, qui était liée au déficit de liquidation et qui découlait de l'art. 75(1)b). L'évolution et l'historique de ces dispositions laissaient croire que le législateur n'a jamais voulu que le déficit de liquidation fasse l'objet d'une fiducie présumée d'origine législative. On ne partageait pas l'opinion de la juge Deschamps selon laquelle on pouvait considérer que le déficit de liquidation était accumulé à la date de la liquidation.

La société a manqué à ses obligations d'administrateur des régimes, et les bénéficiaires auraient dû obtenir de meilleures garanties procédurales dans le cadre de la procédure fondée sur la LACC. La Cour d'appel a conféré une portée excessive aux obligations fiduciaires d'I Ltd. en tant qu'administrateur des régimes. I Ltd. a seulement manqué à son obligation fiduciaire lorsque, une fois devenue insolvable, ses intérêts sont clairement entrés en conflit avec son obligation fiduciaire d'administrateur d'assurer le versement aux régimes de toutes les cotisations devenues exigibles. Son manquement résidait dans l'omission non pas d'éviter ce conflit, qui était en soi inévitable, mais de pallier le problème en veillant à ce que les bénéficiaires des régimes puissent être représentés dans le cadre de la procédure fondée sur la LACC comme si l'administrateur des régimes avait été indépendant.

La Cour d'appel a eu tort de recourir à la fiducie par interprétation, une réparation en equity, pour écarter la superpriorité accordée par le tribunal saisi sur le fondement de la LACC. La Cour d'appel a commis une erreur de principe lorsqu'elle a conclu que l'actif convoité résultait du manquement à l'obligation fiduciaire, de sorte qu'il serait injuste que la partie fautive se l'approprie. L'omission d'I Ltd. de véritablement pallier les conflits d'intérêts auxquels donnait lieu la procédure fondée sur la LACC n'a pas donné lieu à un tel actif. L'imposition d'une fiducie par interprétation était clairement une mesure disproportionnée par rapport au manquement d'I Ltd. à son obligation fiduciaire.

Bien que l'on ne partageait pas l'opinion de la juge Deschamps concernant la portée de la fiducie présumée prévue à l'art. 57(4), on s'accordait avec elle pour affirmer que si l'on devait conclure à l'existence d'une fiducie présumée dans le présent dossier, elle devait prendre rang avant la créance DE en application de la doctrine de la prépondérance fédérale.

Les prétentions du syndicat au sujet des frais reposaient en grande partie sur une interprétation erronée de la décision de la Cour d'appel à cet égard. La Cour d'appel ne considérait pas que le consentement des bénéficiaires du régime était une condition préalable au paiement des dépens à partir de la caisse de retraite. Il était erroné de laisser entendre que la décision relative aux dépens faisait en sorte que les bénéficiaires ne pouvaient être indemnisés des dépens que lorsqu'il existait un surplus dans la caisse de retraite en fiducie ou qu'ils ne pouvaient financer l'exercice d'un recours lorsque la caisse était déficitaire. La décision de la Cour d'appel relativement aux frais n'établissait pas la règle qu'un syndicat représentant les bénéficiaires d'une caisse de retraite ne pouvait être indemnisé de ses dépens par la caisse de retraite parce qu'il n'était pas lui-même bénéficiaire. Comme l'instance engagée en l'espèce portait sur des points de droit nouveaux, il était entendu que son issue était incertaine. L'échec du recours ne saurait justifier que tous les participants d'un régime déjà sous-capitalisé subissent les conséquences pécuniaires du risque couru.

L'argument du syndicat reposait apparemment sur la prémisse que les participants du régime des salariés devraient obtenir paiement de leurs dépens à partir de leur caisse de retraite puisque c'est ce à quoi les participants au régime des cadres avaient droit. Or, telle n'était pas la teneur exacte de l'ordonnance de la Cour d'appel relative au régime des cadres. La Cour d'appel n'appliquait pas au régime des cadres le critère qui, selon le syndicat, vaudrait pour le paiement des dépens, car l'ordonnance relative aux dépens découlait d'un accord et elle ne prévoyait pas le paiement des dépens par prélèvement sur la caisse de retraite dans sa globalité. S'agissant de la demande du syndicat, nul accord n'était intervenu au même effet, et ce n'était pas seulement les participants derrière le recours qui s'exposaient au risque lié à l'issue de celui-ci. Il n'y avait aucune erreur de principe dans le refus de la Cour d'appel d'ordonner que les dépens du syndicat soient payés à partir de la caisse de retraite, étant donné surtout l'issue du présent appel.

LeBel, J. (dissident) (Abella, J., souscrivant à son opinion) : On s'accordait à dire que le régime des cadres ne pouvait être protégé par aucune fiducie présumée résultant de l'application de l'art. 57(4) de la LRR, puisque ce régime n'avait pas été liquidé lorsque la procédure fondée sur la LACC a été enclenchée. On partageait l'opinion de la juge Deschamps, laquelle reconnaissait l'existence d'une fiducie présumée dans le cas du déficit de liquidation du régime des salariés mais aussi que la créance des prêteurs DE avait priorité sur toutes les autres créances, par application du principe de la prépondérance fédérale.

Toutefois, la fiducie par interprétation pouvait s'appliquer aux présentes circonstances et devrait être imposée en l'espèce. On a adopté un point de vue différent de celui des juges majoritaires en ce qui a trait à la nature et la portée des obligations fiduciaires d'un employeur qui choisit d'administrer un régime de retraite régi par la LRR. Sa double fonction n'autorisait pas l'employeur à faire preuve de laxisme dans la définition et l'exercice de ses obligations fiduciaires, ni ne justifiait ses actes répréhensibles. I Ltd. a non seulement manqué à ses obligations envers les bénéficiaires, mais a adopté en fait une démarche qui allait à l'encontre de leurs intérêts. La gravité de ces manquements justifiait amplement la décision de la Cour d'appel d'imposer une fiducie par interprétation. Les conditions qui justifient généralement l'imposition d'une fiducie par interprétation étaient satisfaites. En imposant la fiducie, la Cour n'a pas négligé le fait qu'I Ltd. et I É.-U. constituaient des personnes morales distinctes. Elle a tenu compte à juste titre de leurs rapports étroits, la seconde contrôlant dans les faits la première. Il fallait prendre ces rapports en compte.

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s. 2(1) "secured creditor" — considered

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s. 22(2) — considered

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Generally — referred to

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s. 23(4)(a) [en. 1983, c. 2, s. 3] — considered

s. 23(4)(b) [en. 1983, c. 2, s. 3] — considered

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Generally — referred to

s. 1(1) "administrator" — considered

s. 8(1)(a) — considered

s. 22(4) — considered

s. 56(1) — considered

s. 56(2) — considered

s. 57(3) — considered

s. 57(4) — considered

s. 59 — considered

s. 69(1) — considered

s. 69(1)(d) — considered

s. 75(1)(a) — considered

s. 75(1)(b) — considered

s. 75(1)(b)(i) — considered

s. 75(1)(b)(ii) — considered

s. 75(1)(b)(iii) — considered

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s. 32 — considered

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Generally — referred to

s. 1(1) "wind up" — considered

s. 8(1)(a) — considered

s. 9 — referred to

s. 10(1) ¶ 12 — referred to

s. 12 — referred to

s. 19 — referred to

s. 20 — referred to

s. 22(1) — considered

s. 22(2) — considered

s. 22(4) — considered

s. 25 — referred to

s. 26 — referred to

s. 42 — referred to

s. 56 — considered

s. 57 — considered

s. 57(3) — considered

s. 57(4) — considered

s. 58(1) — considered

s. 58(3) — considered

s. 58(4) — considered

s. 59 — referred to

s. 68(2)(c) — considered

s. 70 — referred to

s. 70(1) — considered

s. 70(6) — considered

s. 73 — referred to

s. 74 — considered

s. 75 — considered

s. 75(1) — considered

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Generally — referred to

s. 22(4) — considered

s. 57(4) — considered

Regulations considered by *Deschamps J.*:

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General, R.R.O. 1990, Reg. 909

s. 31 — considered

Regulations considered by *Cromwell J.*:

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General, R.R.O. 1990, Reg. 909

s. 4(4) ¶ 3 — considered

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Words and phrases considered:

amount of money equal to employer contributions accrued to the date of the wind up but not yet due under the plan or regulations

[Per Deschamps J. (Moldaver J. concurring):] Since both the amount with respect to payments (s. 75(1)(a)) [*Pension Benefits Act*, R.S.O. 1990, c. P.8] and the one ascertained by subtracting the assets from the liabilities accrued as of the date of the wind up (s. 75(1)(b)) are to be paid upon wind up as employer contributions, they are both included in the ordinary meaning of the words of s. 57(4) of the *PBA*: "amount of money equal to employer contributions accrued to the date of the wind up but not yet due under the plan or regulations". . . .

. . . . .

[A] contribution has "accrued" when the liabilities are completely constituted, even if the payment itself will not fall due until a later date. If this principle is applied to the facts of this case, the liabilities related to contributions to the fund allocated for payment of the pension benefits contemplated in s. 75(1)(b) are completely constituted at the time of the wind up, because no pension entitlements arise after that date. In other words, no new liabilities accrue at the time of or after the wind up. Even the portion of the contributions that is related to the elections plan members may make upon wind up has "accrued to the date of the wind up", because it is based on rights employees earned before the wind-up date.

The fact that the precise amount of the contribution is not determined as of the time of the wind up does not make it a contingent contribution that cannot have accrued for accounting purposes (*Canadian Pacific Ltd. v. Ontario (Minister of Revenue)* (1998), 41 O.R. (3d) 606 (Ont. C.A.), at p. 621). The use of the word "accrued" does not limit liabilities to amounts that can be determined with precision. As a result, the words "contributions accrued" can encompass the contributions mandated by s. 75(1)(b) of the *PBA*.

accrued to the date of the wind up

[Per Cromwell J. (concurring in the result) (McLachlin C.J.C. and Rothstein J. concurring):] [T]he most plausible grammatical and ordinary sense of the words "accrued to the date of the wind up" is that the amounts referred to are precisely ascertained immediately before the effective date of the plan's wind-up. The wind-up deficiency only arises upon wind-up and it is neither ascertained nor ascertainable on the date fixed for wind-up. . . . the broader statutory context reinforces this view: the language of the deemed trusts in s. 57(3) and (4) [*Pension Benefits Act*, R.S.O. 1990, c. P.8] is virtually exactly repeated in s. 75(1)(a), suggesting that both deemed trusts refer to the liability on wind-up referred to in s. 75(1)(a) and not to the further and distinct wind-up deficiency liability created under s. 75(1)(b). . . . the legislative evolution and history of these provisions show, in my view, that the legislature never intended to include the wind-up deficiency in a statutory deemed trust.

. . . . .

In my view, the most plausible grammatical and ordinary sense of the phrase "accrued to the date of the wind up" in s. 57(4) is that it refers to the sums that are ascertained immediately before the effective wind-up date of the plan.

In the context of s. 57(4), the grammatical and ordinary sense of the term "accrued" is that the amount of the obligation is "fully constituted" and "ascertained" although it may not yet be payable. The amount of the wind-up deficiency is not fully constituted or ascertained (or even ascertainable) before or even on the date fixed for wind up and therefore cannot fall under s. 57(4).

Of course, the meaning of the word "accrued" may vary with context. In general, when the term "accrued" is used in relation to legal rights, its common meaning is that the right has become fully constituted even though the monetary implications of its enforcement are not yet known or knowable. Thus, we speak of the "accrual" of a cause of action in tort when all of the elements of the cause of action come into existence, even though the extent of the damage may well not be known or knowable at that time: see, e.g., *Ryan v. Moore*, 2005 SCC 38, [2005] 2 S.C.R. 53 (S.C.C.). However, when the term is used in relation to a sum of money, it will generally refer to an amount that is at the present time either quantified or exactly quantifiable but which may or may not be due.

. . . . .

In other contexts, an amount which has accrued may not yet be due. For example, we speak of "accrued interest" meaning a precise, quantified amount of interest that has been earned but may not yet be payable. The term "accrual" is used in the same way in "accrual accounting". In accrual method accounting, "transactions that give rise to revenue or costs are recognized in the accounts when they are earned and incurred respectively": B. J. Arnold, *Timing and Income Taxation: The Principles of Income Measurement for Tax Purposes* (1983), at p. 44. Revenue is earned when the recipient "substantially completes performance of everything he or she is required to do as long as the amount due is ascertainable and there is no uncertainty about its collection": P. W. Hogg, J. E. Magee and J. Li, *Principles of Canadian Income Tax Law* (7th ed., 2010), at s. 6.5(b); see also Canadian Institute of Chartered Accountants, *CICA Handbook — Accounting*, Part II, s. 1000, at paras. 41-44. In this context, the amount must be ascertained at the time of accrual.

. . . . .

I turn next to the ordinary and grammatical sense of the words "to the date of the wind up" in s. 57(4). In my view, these words indicate that only those contributions that accrue before the date of wind up, and not those amounts the liability for which arises only on the day of wind up — that is, the wind-up deficiency — are included.

Where the legislature intends to include the date of wind up, it has used suitable language to effect that purpose. For example, the English version of a provision amending the *PBA* in 2010 (c. 24, s. 21(2)), s. 68(2)(c), indicates which trade unions are entitled to notice of the wind up:

(2) If the employer or the administrator, as the case may be, intends to wind up the pension plan, the administrator shall give written notice of the intended wind up to,

. . . . .

(c) each trade union that represents members of the pension plan or that, <u>on the date of the wind up</u>, represented the members, former members or retired members of the pension plan;

In contrast to the phrase "to the date of wind up", "on the date of wind up" clearly includes the date of wind up. (The French version does not indicate a different intention.) Similarly, s. 70(6), which formed part of the *PBA* until 2012 (rep. S.O. 2010, c. 9, s. 52(5)), read as follows:

(6) On the partial wind up of a pension plan, members, former members and other persons entitled to benefits under the pension plan shall have rights and benefits that are not less than the rights and benefits they would have on a full wind up of the pension plan <u>on the effective date of the partial wind up</u>.

The words "on the effective date of the partial wind up" indicate that the members are entitled to those benefits from the date of the partial wind up, in the sense that members can claim their benefits beginning on the date of the wind up itself. This is how the legislature expresses itself when it wants to speak of a period of time including a specific date. By comparison, "to the date of the wind up" is devoid of language that would include the actual date of wind up.

To sum up with respect to the ordinary and grammatical meaning of the phrase "accrued to the date of the wind up", the most plausible ordinary and grammatical meaning is that such amounts are fully constituted and precisely ascertained immediately before the date fixed as the date of wind up. Thus, according to the ordinary and grammatical meaning of the words, the wind-up deficiency obligation set out in s. 75(1)(b) has not "*accrued* to the date of the wind up" as required by s. 57(4). Moreover, the liability for the wind-up deficiency arises where a pension plan is wound up (s. 75(1)(b)) and so it cannot be a liability that "accrued *to the date of the wind up*" (s. 57(4)).

fiduciary relationship

[Per LeBel J. (dissenting) (Abella J. concurring):] A fiduciary relationship is a relationship, grounded in fact and law, between a vulnerable beneficiary and a fiduciary who holds and may exercise power over the beneficiary in situations recognized by law.

Termes et locutions cités:

montant égal aux cotisations de l'employeur qui sont accumulées à la date de la liquidation, mais qui ne sont pas encore dues aux termes du régime ou des règlements

[Deschamps, J. (Moldaver, J., souscrivant à son opinion):] Puisque le montant des paiements (al. 75(1)a) [*Loi sur les régimes de retraite*, L.R.O. 1990, ch. P.8] et le montant établi en soustrayant l'actif du passif accumulé à la date de la liquidation (al. 75(1)b)) doivent tous les deux être versés à la liquidation à titre de cotisations de l'employeur, ils entrent tous les deux dans le sens ordinaire des mots employés au par. 57(4) de la *LRR*: montant égal aux cotisations de l'employeur qui sont accumulées à la date de la liquidation, mais qui ne sont pas encore dues aux termes du régime ou des règlements ». . . .

. . . . .

[U]ne cotisation est « accumulée » lorsque le passif est entièrement constitué, même si le paiement lui-même ne devient exigible que plus tard. Cela signifie en l'espèce que le passif au titre des cotisations à la caisse destinée au paiement des prestations de retraite visées à l'al. 75(1)b) est entièrement constitué lorsque la liquidation a lieu, parce qu'aucun droit au titre de la pension ne prend naissance après cette date. Autrement dit, aucun passif ne s'accumule pendant ni après la liquidation. Même la portion des cotisations afférente aux options que les participants peuvent exercer lorsqu'il y a liquidation est « accumulé[e] à la date de la liquidation » parce qu'elle est fondée sur des droits que les employés ont acquis avant la date de la liquidation.

Le fait que le montant précis des cotisations n'est pas établi au moment de la liquidation ne confère pas aux cotisations un caractère éventuel qui ferait en sorte qu'elles ne seraient pas accumulées d'un point de vue comptable (*Canadian Pacific Ltd. c. M.N.R.* (1998), 41 O.R. (3d) 606 (C.A.), p. 621). L'emploi du mot « accumulé » ne limite pas le passif aux seuls montants qui peuvent être établis avec précision. On peut donc considérer que le passif « accumulé » englobe les cotisations exigées au par. 75(1)b) de la *LRR*.

accumulées à la date de la liquidation

[Cromwell, J. (souscrivant au résultat des juges majoritaires) (McLachlin, J.C.C., Rothstein, J., souscrivant à son opinion):] [S]uivant son sens ordinaire et grammatical le plus plausible, l'expression « accumulées à la date de la liquidation » renvoie aux sommes déterminées de façon précise immédiatement avant la date de prise d'effet de la liquidation du régime. Le déficit de liquidation n'est constaté qu'à l'issue de la liquidation, et il n'est ni déterminé ni déterminable à la date de liquidation prévue. . . . [L]e contexte législatif général me conforte dans ce point de vue. Le texte des par. 57(3) et (4) [*Loi sur les régimes de retraite*, L.R.O. 1990, ch. P.8] qui dispose qu'il y a fiducie réputée est repris presque en tous points à l'al. 75(1)a), ce qui permet de conclure que, dans les deux cas de fiducie réputée, le législateur renvoie à l'obligation qui existe à la liquidation suivant l'al. 75(1)a) et non à celle, supplémentaire et distincte, qui est liée au déficit de liquidation et qui découle de l'al. 75(1)b). . . . [I]l appert à mon sens de l'évolution et de l'historique de ces dispositions que le législateur n'a jamais voulu que le déficit de liquidation fasse l'objet d'une fiducie réputée d'origine législative.

. . . . .

À mon avis, suivant son sens ordinaire et grammatical le plus plausible, l'expression « accumulées à la date de la liquidation » employée au par. 57(4) renvoie aux sommes déterminées immédiatement avant la date de prise d'effet de la liquidation du régime.

Dans le contexte du par. 57(4), le sens ordinaire et grammatical d'« accumulées » veut que l'obligation soit « entièrement constituée » et que son montant soit « déterminé », même si elle peut ne pas être encore payable. Le déficit de liquidation n'est pas entièrement constitué ni son montant déterminé (ou déterminable) avant la date prévue pour la liquidation, ou le jour même, et ne peut donc pas être visé au par. 57(4).

Certes, le sens du terme « accumulées » [et plus encore celui de son équivalent anglais « accrued »] peut varier selon le contexte. En général, lorsque ce terme est employé de pair avec des droits légaux, son sens courant veut que le droit soit entièrement constitué, même si les répercussions financières de son exécution ne sont pas encore connues et ne peuvent l'être. Ainsi, en responsabilité délictuelle, on parle d'accumulation (au sens d'acquisition ou de naissance) de la cause d'action lorsque tous ses éléments sont réunis, même lorsque l'étendue du préjudice n'est pas encore connue ou ne peut l'être (voir, p. ex., *Ryan c. Moore*, 2005 CSC 38, [2005] 2 R.C.S. 53 (S.C.C.). Toutefois, lorsque le terme qualifie une somme, il renvoie généralement à un élément dont la valeur est actuellement mesurée ou mesurable, mais qui peut ou non être dû.

. . . . .

Dans d'autres cas, la somme qui s'est accumulée [en anglais, « accrued »] peut ne pas être encore exigible. Par exemple, on parle d'« intérêts accumulés » [« accrued interests »] au sens du montant précis des intérêts qui sont courus, mais qui ne sont pas encore exigibles. En anglais, accrual est utilisé dans le même sens dans l'expression « accrual accounting » (en français, comptabilité d'exercice). Suivant cette méthode, les [traduction] « opérations qui génèrent des revenus ou occasionnent des dépenses sont comptabilisées lorsque les revenus sont gagnés ou que les dépenses sont engagées » (B. J. Arnold, *Timing and Income Taxation: The Principles of Income Measurement for Tax Purposes* (1983), à la p. 44). Le revenu est gagné lorsque le bénéficiaire [traduction] « a essentiellement accompli tout ce qu'il devait accomplir, à condition que la somme due puisse être déterminée et que sa perception ne fasse l'objet d'aucune incertitude » (P. W. Hogg, J. E. Magee et J. Li, *Principles of Canadian Income Tax Law* (7e éd. 2010), à l'al. 6.5b); voir également le Manuel de l'Institut canadien des comptables agréés, *Manuel de l'ICCA - Comptabilité*, partie II, ch. 1000, aux par. 41 à 44). La somme en cause doit alors être déterminée au moment où le droit de la toucher est acquis [« accrued »].

. . . . .

J'examine maintenant le sens ordinaire et grammatical des mots « à la date de la liquidation » (en anglais, « to the date of the wind up ») employés au par. 57(4). À mon avis, cette expression fait en sorte que seules sont visées les cotisations accumulées avant la date de la liquidation, et non les sommes qui font l'objet d'une obligation qui ne prend naissance que le jour de la liquidation (en anglais, « on the date of the wind up ») et qui correspondent au déficit de liquidation.

Si l'intention du législateur avait été d'englober la date de la liquidation, il aurait employé le libellé voulu. Par exemple, l'al. 68(2)c) de la *LRR*, modifié en 2010 (ch. 24, par. 21(2)), précise dans sa version anglaise quels syndicats doivent recevoir avis de la liquidation:

(2) If the employer or the administrator, as the case may be, intends to wind up the pension plan, the administrator shall give written notice of the intended wind up to,

. . . . .

(c) each trade union that represents members of the pension plan or that, on the date of the wind up [à la date de la liquidation], represented the members, former members or retired members of the pension plan;

Contrairement à la formule « to the date of wind up », l'expression « on the date of wind up » englobe clairement la date de la liquidation. (La version française ne se prête pas à une autre interprétation.) De même, le par. 70(6), qui figurait dans la *LRR* jusqu'en 2012 (abr. L.O. 2010, ch. 9, par. 52(5)), énonce ce qui suit:

(6) À la liquidation partielle d'un régime de retraite, les participants, les anciens participants et les autres personnes qui ont droit à des prestations en vertu du régime de retraite ont des droits et prestations qui ne sont pas inférieurs aux droits et prestations qu'ils auraient à la liquidation totale du régime de retraite à la date de prise d'effet de la liquidation partielle [on the effective date of the partial wind up].

Il appert de l'expression anglaise « on the effective date of the partial wind up » que les participants ont droit aux prestations à compter de la date de la liquidation partielle, c'est-à-dire qu'ils peuvent les réclamer à compter de la liquidation elle-même. Le législateur s'exprime ainsi lorsqu'il veut qu'une période englobe une date précise. À l'opposé, lorsqu'il dit en anglais « to the date of the wind up » (en français, à la date de la liquidation), il n'entend pas englober la date où survient la liquidation.

Bref, le sens ordinaire et grammatical le plus plausible d'« accumulées à la date [to the date] de la liquidation » veut que soient visées les sommes entièrement constituées et déterminées immédiatement avant la date prévue de liquidation. Ainsi, l'obligation liée au déficit de liquidation visé à l'al. 75(1)b) n'est donc pas « accumul[é] à la date [to the date] de la liquidation » comme l'exige le par. 57(4). De plus, comme cette obligation naît lorsque le régime de retraite est liquidé (al. 75(1)b)), son objet ne peut donc pas être « accumul[é] à la date de la liquidation » (par. 57(4)).

relation fiduciaire

[LeBel, J. (dissident) (Abella, J., souscrivant à son opinion):] Une relation fiduciaire s'entend de la relation factuelle et juridique entre un bénéficiaire vulnérable et un fiduciaire qui détient et peut exercer un pouvoir sur le bénéficiaire dans les situations prévues par la loi.

APPEAL by company, monitor, secured creditor, and trustee in bankruptcy from judgment reported at *Indalex Ltd., Re* (2011), 89 C.C.P.B. 39, 276 O.A.C. 347, 331 D.L.R. (4th) 352, 17 P.P.S.A.C. (3d) 194, 75 C.B.R. (5th) 19, 104 O.R. (3d) 641, 2011 C.E.B. & P.G.R. 8433, 2011 ONCA 265, 2011 CarswellOnt 2458 (Ont. C.A.), ordering distribution from reserve fund to pay amount of pension plan deficiencies; APPEAL by union from judgment reported at *Indalex Ltd., Re* (2011), 81 C.B.R. (5th) 165, 92 C.C.P.B. 277, 2011 ONCA 578, 2011 CarswellOnt 9077 (Ont. C.A.), issuing costs endorsement.

POURVOI formé par une société, un contrôleur, un créancier garanti et un syndic de faillite à l'encontre d'une décision publiée à *Indalex Ltd., Re* (2011), 89 C.C.P.B. 39, 276 O.A.C. 347, 331 D.L.R. (4th) 352, 17 P.P.S.A.C. (3d) 194, 75 C.B.R. (5th) 19, 104 O.R. (3d) 641, 2011 C.E.B. & P.G.R. 8433, 2011 ONCA 265, 2011 CarswellOnt 2458 (Ont. C.A.), ayant ordonné de combler le déficit des régimes par prélèvement sur le fonds de réserve; POURVOI formé par un syndicat à l'encontre d'un jugement publié à *Indalex Ltd., Re* (2011), 81 C.B.R. (5th) 165, 92 C.C.P.B. 277, 2011 ONCA 578, 2011 CarswellOnt 9077 (Ont. C.A.), ayant adjugé les dépens.

***Deschamps J.*:**

1 Insolvency can trigger catastrophic consequences. Often, large claims of ordinary creditors are left unpaid. In insolvency situations, the promise of defined benefits made to employees during their employment is put at risk. These appeals illustrate the materialization of such a risk. Although the employer in this case breached a fiduciary duty, the harm suffered by the pension plans' beneficiaries results not from that breach, but from the employer's insolvency. For the following reasons, I would allow the appeals of the appellants Sun Indalex Finance, LLC; George L. Miller, Indalex U.S.'s trustee in bankruptcy and FTI Consulting Canada ULC.

2 To improve the prospect of pensioners receiving their full benefits after a pension plan is wound up, the Ontario legislature has protected contributions to the pension fund that have accrued but are not yet due at the time of the wind up by providing for a deemed trust that supersedes all other provincial priorities over certain assets of the plan sponsor (s. 57(4) of the *Pension Benefits Act*, R.S.O. 1990, c. P.8 ("*PBA*"), and s. 30(7) of the *Personal Property Security Act*, R.S.O. 1990, c. P.10 ("*PPSA*")). The parties disagree on the scope of the deemed trust. In my view, the relevant provisions and the context lead to the conclusion that it extends to contributions the employer must make to ensure that the pension fund is sufficient to cover liabilities upon wind up. In the instant case, however, the deemed trust is superseded by the security granted to the creditor that loaned money to the employer, Indalex Limited ("Indalex"), during the insolvency proceedings. In addition, although the employer, as plan administrator, may have put itself in a position of conflict of interest by failing to give the plan's members proper notice of a motion requesting financing of its operations during a restructuring process, there was no realistic possibility that, had the members received notice and had the *CCAA* court found that they were secured creditors, it would have ordered the priorities differently. Consequently, it would not be appropriate to order an equitable remedy such as the constructive trust ordered by the Court of Appeal.

I. Facts

3 Indalex is a wholly owned Canadian subsidiary of a U.S. company, Indalex Holding Corp. ("Indalex U.S."). Indalex and its related companies formed a corporate group (the "Indalex Group") that manufactured aluminum extrusions. The U.S. and Canadian operations were closely linked.

4 In 2009, a combination of high commodity prices and the economic recession's impact on the end-user market for aluminum extrusions plunged the Indalex Group into insolvency. On March 20, 2009, Indalex U.S. filed for Chapter 11 bankruptcy protection in Delaware. On April 3, 2009, Indalex applied for a stay under the *Companies' Creditors Arrangement Act*, R.S.C. 1985, c. C-36 ("*CCAA*"), and Morawetz J. granted the stay in an initial order. He also appointed FTI Consulting Canada ULC (the "Monitor") to act as monitor.

5 At that time, Indalex was the administrator of two registered pension plans. One was for its salaried employees (the "Salaried Plan"), the other for its executives (the "Executive Plan"). Members of the Salaried Plan included seven employees for whom the United Steelworkers ("USW") acted as bargaining agent. The Salaried Plan was in the process of being wound up when the *CCAA* proceedings began. The effective date of the wind up was December 31, 2006. The Executive Plan had been closed but not wound up. Overall, the deficiencies of the pension plans' funds concern 49 persons (members of the Salaried Plan and the Executive Plan are referred to collectively as the "Plan Members").

6 Pursuant to the initial order made by Morawetz J. on April 3, 2009, Indalex obtained protection under the *CCAA*. Both plans faced funding deficiencies when Indalex filed for the *CCAA* stay. The wind-up deficiency of the Salaried Plan was estimated at $1.8 million as of December 31, 2008. The funding deficiency of the Executive Plan was estimated at $3.0 million on a wind-up basis as of January 1, 2008.

7 From the beginning of the insolvency proceedings, the Indalex Group's reorganization strategy was to sell both Indalex and Indalex U.S. as a going concern while they were under *CCAA* and Chapter 11 protection. To this end, Indalex and Indalex U.S. sought to enter into a common agreement for debtor-in-possession ("DIP") financing under which the two companies could draw from joint credit facilities and would guarantee each other's liabilities.

8 Indalex's financial distress threatened the interests of all the Plan Members. If the reorganization failed and Indalex were liquidated under the *Bankruptcy and Insolvency Act*, R.S.C. 1985, c. B-3 ("*BIA*"), they would not have recovered any of their claims against Indalex for the underfunded pension liabilities, because the priority created by the provincial statute would not be recognized under the federal legislation: *Husky Oil Operations Ltd. v. Minister of National Revenue*, [1995] 3 S.C.R. 453 (S.C.C.). Although the priority was not rendered ineffective by the *CCAA*, the Plan Members' position was uncertain.

9 The Indalex Group solicited terms from a variety of possible DIP lenders. In the end, it negotiated an agreement with a syndicate consisting of the pre-filing senior secured creditors. On April 8, 2009, the *CCAA* court issued an Amended and Restated Initial Order ("Amended Initial Order") authorizing Indalex to borrow US$24.4 million from the DIP lenders and grant them priority over all other creditors ("DIP charge") in that amount. In his endorsement of the order, Morawetz J. made a finding that Indalex would be unable to achieve a going-concern solution without DIP financing. Such financing was necessary to support Indalex's business until the sale could be completed.

10 The Plan Members did not participate in the initial proceedings. The initial stay had been granted *ex parte*. The *CCAA* judge ordered Indalex to serve a copy of the stay order on every creditor owed $5,000 or more within 10 days of the initial order of April 3. As of April 8, when the motion to amend the initial order was heard, none of the Executive Plan's members had been served with that order; nor did any of them receive notice of the motion to amend it. The USW did receive short notice, but chose not to attend. Morawetz J. authorized Indalex to proceed on the basis of an abridged time for service. The Plan Members were given notice of all subsequent proceedings. None of the Plan Members appealed the Amended Initial Order to contest the DIP charge.

11 On June 12, 2009, Indalex applied for authorization to increase the DIP loan amount to US$29.5 million. At the hearing, the Executive Plan's members initially opposed the motion, seeking to reserve their rights. After it was confirmed that the motion was merely to increase the amount of the DIP charge (without changing the terms of the loan), they withdrew their opposition and the court granted the motion.

12 On April 22, 2009, the court extended the stay of proceedings and approved a marketing process for the sale of Indalex's assets. The Plan Members did not oppose the application to approve the marketing process. Under the approved bidding procedure, the Indalex Group solicited a wide variety of potential buyers.

13 Indalex received a bid from SAPA Holding AB ("SAPA"). It was for approximately US$30 million, and SAPA did not assume responsibility for the pension plans' wind-up deficiencies. According to the Monitor's estimate, the liquidation value of Indalex's assets was US$44.7 million. Indalex brought an application for an order approving a bidding procedure for a competitive auction and deeming SAPA's bid to be a qualifying bid. The Executive Plan's members opposed the application, expressing concern that the pension liabilities would not be assumed. Morawetz J. nevertheless issued the order on July 2, 2009; in it, he approved the bidding procedure for sale, noting that the Executive Plan's members could raise their objections at the time of approval of the final bid.

14 The bidding procedure did not trigger any competing bids. On July 20, 2009, Indalex and Indalex U.S. brought motions before their respective courts to approve the sale of substantially all their assets under the terms of SAPA's bid. Indalex also moved for approval of an interim distribution of the sale proceeds to the DIP lenders. The Plan Members opposed Indalex's motion. First, they argued that it was estimated that a forced liquidation would produce greater proceeds than SAPA's bid. Second, they contended that their claims had priority over that of the DIP lenders because the unfunded pension liabilities were subject to a statutory deemed trust under the *PBA*. They also contended that Indalex had breached its fiduciary obligations by failing to meet its obligations as a plan administrator throughout the insolvency proceedings.

15 The court dismissed the Plan Members' first objection, holding that there was no evidence supporting the argument that a forced liquidation would be more beneficial to suppliers, customers and the 950 employees. It approved the sale on

July 20, 2009. The order in which it did so directed the Monitor to make a distribution to the DIP lenders. With respect to the second objection, however, Campbell J. ordered the Monitor to hold a reserve in an amount to be determined by the Monitor, leaving the Plan Members' arguments based on their right to the proceeds of the sale open for determination at a later date.

16 The sale to SAPA closed on July 31, 2009. The Monitor collected $30.9 million in proceeds. It distributed US $17 million to the DIP lenders, paid certain fees, withheld a portion to cover various costs and retained $6.75 million in reserve pending determination of the Plan Members' rights. At the closing, Indalex owed US$27 million to the DIP lenders. The payment of US$17 million left a US$10 million shortfall in the amount owed to these lenders. The DIP lenders called on Indalex U.S. to cover this shortfall under the guarantee contained in the DIP lending agreement. Indalex U.S. paid the amount of the shortfall. Since Indalex U.S. was, as a term of the guarantee, subrogated to the DIP lenders' priority, it became the highest ranking creditor of Indalex, with a claim for US$10 million.

17 Following the sale of Indalex's assets, its directors resigned. Indalex U.S., a part of Indalex Group, took over the management of Indalex, whose assets were limited to the sale proceeds held by the Monitor. A Unanimous Shareholder Declaration was executed on August 12, 2009; in it, Mr. Keith Cooper was appointed to manage Indalex's affairs. Mr. Cooper was an employee of FTI Consulting Inc.

18 In accordance with the right reserved by the court on July 20, 2009, the Plan Members brought motions on August 28, 2009 for a declaration that a deemed trust equal in amount to the unfunded pension liability was enforceable against the proceeds of the sale. They contended that they had priority over the secured creditors pursuant to s. 57(4) of the PBA and s. 30(7) of the *PPSA*. Indalex, in turn, brought a motion for an assignment in bankruptcy to secure the priority regime it argued for in opposing the Plan Members' motions.

19 On October 14, 2009, while judgment was pending, Indalex U.S. converted the Chapter 11 restructuring proceeding in the U.S. into a Chapter 7 liquidation proceeding. On November 5, 2009, the Superintendent of Financial Services ("Superintendent") appointed the actuarial firm of Morneau Sobeco Limited Partnership ("Morneau") to replace Indalex as administrator of the plans.

20 On February 18, 2010, Campbell J. dismissed the Plan Members' motions, concluding that the deemed trust did not apply to the wind-up deficiencies, because the associated payments were not "due" or "accruing due" as of the date of the wind up. He found that the Executive Plan did not have a wind-up deficiency, since it had not yet been wound up. He thus found it unnecessary to rule on Indalex's motion for an assignment in bankruptcy (2010 ONSC 1114, 79 C.C.P.B. 301 (Ont. S.C.J. [Commercial List])). The Plan Members appealed the dismissal of their motions.

21 The Ontario Court of Appeal allowed the Plan Members' appeals. It found that the deemed trust created by s. 57(4) of the *PBA* applies to all amounts due with respect to plan wind-up deficiencies. Although the court noted that it was likely that no deemed trust existed for the Executive Plan on the plain meaning of the provision, it declined to address this question, because it found that the Executive Plan's members had a claim arising from Indalex's breach of its fiduciary obligations in failing to adequately protect the Plan Members' interests (2011 ONCA 265, 104 O.R. (3d) 641 (Ont. C.A.)).

22 The Court of Appeal concluded that a constructive trust was an appropriate remedy for Indalex's breach of its fiduciary obligations. The court was of the view that this remedy did not harm the DIP lenders, but affected only Indalex U.S. It imposed a constructive trust over the reserved fund in favour of the Plan Members. Turning to the question of distribution, it also found that the deemed trust had priority over the DIP charge because the issue of federal paramountcy had not been raised when the Amended Initial Order was issued, and that Indalex had stated that it intended to comply with any deemed trust requirements. The Court of Appeal found that there was nothing in the record to suggest that not applying the paramountcy doctrine would frustrate Indalex's ability to restructure.

23 The Court of Appeal ordered the Monitor to make a distribution from the reserve fund in order to pay the amount of each plan's deficiency. It also issued a costs endorsement that approved payment of the costs of the Executive Plan's

members from that plan's fund, but declined to order the payment of costs to the USW from the fund of the Salaried Plan (2011 ONCA 578, 81 C.B.R. (5th) 165 (Ont. C.A.)).

24 The Monitor, together with Sun Indalex, a secured creditor of Indalex U.S., and George L. Miller, Indalex U.S.'s trustee in bankruptcy, appeals the Court of Appeal's order. Both the Superintendent and Morneau support the Plan Members' position as respondents. A number of stakeholders are also participating in the appeals to this Court. In addition, USW appeals the costs endorsement. As I agree with my colleague Cromwell J. on the appeal from the costs endorsement, I will not deal with it in these reasons.

II. Issues

25 The appeals raise four issues:

1. Does the deemed trust provided for in s. 57(4) of the *PBA* apply to wind-up deficiencies?

2. If so, does the deemed trust supersede the DIP charge?

3. Did Indalex have any fiduciary obligations to the Plan Members when making decisions in the context of the insolvency proceedings?

4. Did the Court of Appeal properly exercise its discretion in imposing a constructive trust to remedy the breaches of fiduciary duties?

III. Analysis

A. Does the Deemed Trust Provided for in Section 57(4) of the PBA Apply to Windup Deficiencies?

26 The first issue is whether the statutory deemed trust provided for in s. 57(4) of the *PBA* extends to wind-up deficiencies. This question is one of statutory interpretation, which requires examination of both the wording and context of the relevant provisions of the *PBA*. Section 57(4) of the *PBA* affords protection to members of a pension plan with respect to their employer's contributions upon wind up of the plan. The provision reads:

> **57.** . . .
>
> (4) Where a pension plan is wound up in whole or in part, an employer who is required to pay contributions to the pension fund shall be deemed to hold in trust for the beneficiaries of the pension plan an amount of money equal to employer contributions accrued to the date of the wind up but not yet due under the plan or regulations.

27 The most obvious interpretation is that where a plan is wound up, this provision protects all contributions that have accrued but are not yet due. The words used appear to include the contribution the employer is to make where a plan being wound up is in a deficit position. This quite straightforward interpretation, which is consistent with both the historical broadening of the protection and the remedial purpose of the provision, is being challenged on the basis of a narrow definition of the word "accrued". I do not find that this argument justifies limiting the protection afforded to plan members by the Ontario legislature.

28 The *PBA* sets out the rules for the operation of funded contributory defined benefit pension plans in Ontario. In an ongoing plan, an employer must pay into a fund all contributions it withholds from its employees' salaries. In addition, while the plan is ongoing, the employer must make two kinds of payments. One relates to current service contributions — the employer's own regular contributions to the pension fund as required by the plan. The other ensures that the fund is sufficient to meet the plan's liabilities. The employees' interest in having the contributions made while the plan is ongoing is protected by a deemed trust provided for in s. 57(3) of the *PBA*.

29 The *PBA* also establishes a comprehensive scheme for winding up a pension plan. Section 75(1)(a) imposes on the employer the obligation to "pay" an amount equal to the total of all "payments" that are due or that have accrued and have not been paid into the fund. In addition, s. 75(1)(b) sets out a formula for calculating the amount that must be paid to ensure that the fund is sufficient to cover all liabilities upon wind up. Within six months after the effective date of the wind up, the plan administrator must file a wind-up report that lists the plan's assets and liabilities as of the date of the wind up. If the wind-up report shows an actuarial deficit, the employer must make wind-up deficiency payments. Consequently, s. 75(1)(a) and (b) jointly determine the amount of the contributions owed when a plan is wound up.

30 It is common ground that the contributions provided for in s. 75(1)(a) are covered by the wind-up deemed trust. The only question is whether it also applies to the deficiency payments required by s. 75(1)(b). I would answer this question in the affirmative in view of the provision's wording, context and purpose.

31 It is readily apparent that the wind-up deemed trust provision (s. 57(4) PBA) does not place an express limit on the "employer contributions accrued to the date of the wind up but not yet due", and I find no reason to exclude contributions paid under s. 75(1)(b). Section 75(1)(a) explicitly refers to "an amount equal to the total of all payments" that have *accrued*, even those that were not yet due as of the date of the wind up, whereas s. 75(1)(b) contemplates an "amount" that is calculated on the basis of the value of assets and of liabilities that have *accrued* when the plan is wound up. Section 75(1) reads as follows:

> **75.** (1) Where a pension plan is wound up, the employer shall pay into the pension fund,
>
> > (a) an <u>amount equal to the total of all payments</u> that, under this Act, the regulations and the pension plan, are due or that have <u>accrued</u> and that have not been paid into the pension fund; and
> >
> > (b) an <u>amount</u> equal to the amount by which,
> >
> > > (i) the <u>value of the pension benefits</u> under the pension plan that would be guaranteed by the Guarantee Fund under this Act and the regulations if the Superintendent declares that the Guarantee Fund applies to the pension plan,
> > >
> > > (ii) the <u>value of the pension benefits accrued</u> with respect to employment in Ontario vested under the pension plan, and
> > >
> > > (iii) the <u>value of benefits accrued</u> with respect to employment in Ontario resulting from the application of subsection 39 (3) (50 per cent rule) and section 74,
> >
> > <u>exceed the value of the assets</u> of the pension fund <u>allocated as prescribed for payment of pension benefits accrued</u> with respect to employment in Ontario.

32 Since both the amount with respect to payments (s. 75(1)(a)) and the one ascertained by subtracting the assets from the liabilities accrued as of the date of the wind up (s. 75(1)(b)) are to be paid upon wind up as employer contributions, they are both included in the ordinary meaning of the words of s. 57(4) of the *PBA*: "amount of money equal to employer contributions accrued to the date of the wind up but not yet due under the plan or regulations". As I mentioned above, this reasoning is challenged in respect of s. 75(1)(b), not of s. 75(1)(a).

33 The appellant Sun Indalex argues that since the deficiency is not finally quantified until well after the effective date of the wind up, the liability of the employer cannot be said to have accrued. The Monitor adds that the payments the employer must make to satisfy its wind-up obligations may change over the five-year period within which s. 31 of the *PBA* Regulations, R.R.O. 1990, Reg. 909, requires that they be made. These parties illustrate their argument by referring to what occurred to the Salaried Plan's fund in the case at bar. In 2007-8, Indalex paid down the vast majority of the $1.6 million wind-up deficiency associated with the Salaried Plan as estimated in 2006. By the end of 2008, however, this

deficiency had risen back up to $1.8 million as a result of a decline in the fund's asset value. According to this argument, the amount could not have accrued as of the date of the wind up, because it could not be calculated with certainty.

34 Unlike my colleague Cromwell J., I find this argument unconvincing. I instead agree with the Court of Appeal on this point. The wind-up deemed trust concerns "employer contributions accrued to the date of the wind up but not yet due under the plan or regulations". Since the employees cease to accumulate entitlements when the plan is wound up, the entitlements that are used to calculate the contributions have all been accumulated before the wind-up date. Thus the liabilities of the employer are complete — have accrued — before the wind up. The distinction between my approach and the one Cromwell J. takes is that he requires that it be possible to perform the calculation before the date of the wind up, whereas I am of the view that the time when the calculation is actually made is not relevant as long as the liabilities are assessed as of the date of the wind up. The date at which the liabilities are *reported* or the employer's *option* to spread its contributions as allowed by the regulations does not change the legal nature of the contributions.

35 In *Ontario Hydro-Electric Power Commission v. Albright* (1922), 64 S.C.R. 306 (S.C.C.), Duff J. considered the meaning of the word "accrued" in interpreting the scope of a covenant. He found that

> the word "accrued" according to well recognized usage has, as applied to rights or liabilities the meaning simply of completely constituted — and it may have this meaning although it appears from the context that the right completely constituted or the liability completely constituted is one which is only exercisable or enforceable *in futuro* — a debt for example which is *debitum in praesenti solvendum in futuro*.
>
> [Emphasis added; pp. 312-13.]

36 Thus, a contribution has "accrued" when the liabilities are completely constituted, even if the payment itself will not fall due until a later date. If this principle is applied to the facts of this case, the liabilities related to contributions to the fund allocated for payment of the pension benefits contemplated in s. 75(1)(b) are completely constituted at the time of the wind up, because no pension entitlements arise after that date. In other words, no new liabilities accrue at the time of or after the wind up. Even the portion of the contributions that is related to the elections plan members may make upon wind up has "accrued to the date of the wind up", because it is based on rights employees earned before the wind-up date.

37 The fact that the precise amount of the contribution is not determined as of the time of the wind up does not make it a contingent contribution that cannot have accrued for accounting purposes (*Canadian Pacific Ltd. v. Ontario (Minister of Revenue)* (1998), 41 O.R. (3d) 606 (Ont. C.A.), at p. 621). The use of the word "accrued" does not limit liabilities to amounts that can be determined with precision. As a result, the words "contributions accrued" can encompass the contributions mandated by s. 75(1)(b) of the *PBA*.

38 The legislative history supports my conclusion that wind-up deficiency contributions are protected by the deemed trust provision. The Ontario legislature has consistently expanded the protection afforded in respect of pension plan contributions. I cannot therefore accept an interpretation that would represent a drawback from the protection extended to employees. I will not reproduce the relevant provisions, since my colleague Cromwell J. quotes them.

39 The original statute provided solely for the employer's obligation to pay all amounts required to be paid to meet the test for solvency (*The Pension Benefits Act, 1965*, S.O. 1965, c. 96, s. 22(2)), but the legislature subsequently afforded employees the protection of a deemed trust on the employer's assets in an amount equal to the sums withheld from employees as contributions and sums due from the employer as service contributions (s. 23*a*, added by *The Pension Benefits Amendment Act, 1973*, S.O. 1973, c. 113, s. 6). In a later version, it protected not only contributions that were due, but also those that had accrued, with the amounts being calculated as if the plan had been wound up (*The Pension Benefits Amendment Act, 1980*, S.O. 1980, c. 80).

40 Whereas *all* employer contributions were originally covered by a single provision, the legislature crafted a separate provision in 1980 that specifically imposed on the employer the obligation to fund the wind-up deficiency. At the time, it was clear from the words used in the provision that the amount related to the wind-up deficiency was excluded from the

deemed trust protection (*The Pension Benefits Amendment Act, 1980*). In 1983, the legislature made a distinction between the deemed trust for ongoing employer contributions and the one for certain payments to be made upon wind up (ss. 23(4)(a) and 23(4)(b), added by *Pension Benefits Amendment Act, 1983*, S.O. 1983, c. 2, s. 3). In that version, the wind-up deficiency payments were still excluded from the deemed trust. However, the legislature once again made changes to the protection in 1987. The 1987 version is, in substance, the one that applies in the case at bar. In the *Pension Benefits Act, 1987*, S.O. 1987, c. 35, a specific wind-up deemed trust was maintained, but the wind up deficiency payments were no longer excluded from it, because the limitation that had been imposed until then with respect to payments that were due or had accrued while the plan was ongoing had been eliminated. My comments to the effect that the previous versions excluded the wind-up deficiency payments do not therefore apply to the 1987 statute, since it was materially different.

41 Whereas it is clear from the 1983 amendments that the deemed trust provided for in s. 23(4)(b) was intended to include only current service costs and special payments, this is less clear from the subsequent versions of the *PBA*. To give meaning to the 1987 amendment, I have to conclude that the words refer to a deemed trust in respect of *all* "employer contributions accrued to the date of the wind up but not yet due under the plan or regulations".

42 The employer's liability upon wind up is now set out in a single section which elegantly parallels the wind-up deemed trust provision. It can be seen from the legislative history that the protection has expanded from (1) only the service contributions that were due, to (2) amounts payable calculated as if the plan had been wound up, to (3) amounts that were due and had accrued upon wind up but excluding the wind-up deficiency payments, to (4) all amounts due and accrued upon wind up.

43 Therefore, in my view, the legislative history leads to the conclusion that adopting a narrow interpretation that would dissociate the employer's payment provided for in s. 75(1)(b) of the *PBA* from the one provided for in s. 75(1)(a) would be contrary to the Ontario legislature's trend toward broadening the protection. Since the provision respecting wind-up payments sets out the amounts that are owed upon wind up, I see no historical, legal or logical reason to conclude that the wind-up deemed trust provision does not encompass all of them.

44 Thus, I am of the view that the words and context of s. 57(4) lend themselves easily to an interpretation that includes the wind-up deficiency payments, and I find additional support for this in the purpose of the provision. The deemed trust provision is a remedial one. Its purpose is to protect the interests of plan members. This purpose militates against adopting the limited scope proposed by Indalex and some of the interveners. In the case of competing priorities between creditors, the remedial purpose favours an approach that includes all wind-up payments in the value of the deemed trust in order to achieve a broad protection.

45 In sum, the relevant provisions, the legislative history and the purpose are all consistent with inclusion of the wind-up deficiency in the protection afforded to members with respect to employer contributions upon the wind up of their pension plan. I therefore find that the Court of Appeal correctly held with respect to the Salaried Plan, which had been wound up as of December 31, 2006, that Indalex was deemed to hold in trust the amount necessary to satisfy the wind-up deficiency.

46 The situation is different with respect to the Executive Plan. Unlike s. 57(3), which provides that the deemed trust protecting employer contributions exists while a plan is ongoing, s. 57(4) provides that the wind-up deemed trust comes into existence only when the plan is wound up. This is a choice made by the Ontario legislature. I would not interfere with it. Thus, the deemed trust entitlement arises only once the condition precedent of the plan being wound up has been fulfilled. This is true even if it is certain that the plan will be wound up in the future. At the time of the sale, the Executive Plan was in the process of being, but had not yet been, wound up. Consequently, the deemed trust provision does not apply to the employer's wind-up deficiency payments in respect of that plan.

47 The Court of Appeal declined to decide whether a deemed trust arose in relation to the Executive Plan, stating that it was unnecessary to decide this issue. However, the court expressed concern that a reasoning that deprived the Executive Plan's members of the benefit of a deemed trust would mean that a company under *CCAA* protection could avoid the

priority of the *PBA* deemed trust simply by not winding up an underfunded pension plan. The fear was that Indalex could have relied on its own inaction to avoid the consequences that flow from a wind up. I am not convinced that the Court of Appeal's concern has any impact on the question whether a deemed trust exists, and I doubt that an employer could avoid the consequences of such a security interest simply by refusing to wind up a pension plan. The Superintendent may take a number of steps, including ordering the wind up of a pension plan under s. 69(1) of the *PBA* in a variety of circumstances (see s. 69(1)(d), *PBA*). The Superintendent did not choose to order that the plan be wound up in this case.

B. Does the Deemed Trust Supersede the DIP Charge?

48 The finding that the interests of the Salaried Plan's members in all the employer's wind-up contributions to the Salaried Plan are protected by a deemed trust does not mean that part of the money reserved by the Monitor from the sale proceeds must be remitted to the Salaried Plan's fund. This will be the case only if the provincial priorities provided for in s. 30(7) of the *PPSA* ensure that the claim of the Salaried Plan's members has priority over the DIP charge. Section 30(7) reads as follows:

> (7) A security interest in an account or inventory and its proceeds is subordinate to the interest of a person who is the beneficiary of a deemed trust arising under the *Employment Standards Act* or under the *Pension Benefits Act*.

The effect of s. 30(7) is to enable the Salaried Plan's members to recover from the reserve fund, insofar as it relates to an account or inventory and its proceeds in Ontario, ahead of all other secured creditors.

49 The Appellants argue that any provincial deemed trust is subordinate to the DIP charge authorized by the *CCAA* order. They put forward two central arguments to support their contention. First, they submit that the *PBA* deemed trust does not apply in *CCAA* proceedings because the relevant priorities are those of the federal insolvency scheme, which do not include provincial deemed trusts. Second, they argue that by virtue of the doctrine of federal paramountcy the DIP charge supersedes the *PBA* deemed trust.

50 The Appellants' first argument would expand the holding of *Ted Leroy Trucking Ltd., Re*, 2010 SCC 60, [2010] 3 S.C.R. 379 (S.C.C.), so as to apply federal bankruptcy priorities to *CCAA* proceedings, with the effect that claims would be treated similarly under the *CCAA* and the *BIA*. In *Century Services*, the Court noted that there are points at which the two schemes converge:

> Another point of convergence of the *CCAA* and the *BIA* relates to priorities. Because the *CCAA* is silent about what happens if reorganization fails, the *BIA* scheme of liquidation and distribution necessarily supplies the backdrop for what will happen if a *CCAA* reorganization is ultimately unsuccessful. [para. 23]

51 In order to avoid a race to liquidation under the *BIA*, courts will favour an interpretation of the *CCAA* that affords creditors analogous entitlements. Yet this does not mean that courts may read bankruptcy priorities into the *CCAA* at will. Provincial legislation defines the priorities to which creditors are entitled until that legislation is ousted by Parliament. Parliament did not expressly apply all bankruptcy priorities either to *CCAA* proceedings or to proposals under the *BIA*. Although the creditors of a corporation that is attempting to reorganize may bargain in the shadow of their bankruptcy entitlements, those entitlements remain only shadows until bankruptcy occurs. At the outset of the insolvency proceedings, Indalex opted for a process governed by the *CCAA*, leaving no doubt that although it wanted to protect its employees' jobs, it would not survive as their employer. This was not a case in which a failed arrangement forced a company into liquidation under the *BIA*. Indalex achieved the goal it was pursuing. It chose to sell its assets under the *CCAA*, not the *BIA*.

52 The provincial deemed trust under the *PBA* continues to apply in *CCAA* proceedings, subject to the doctrine of federal paramountcy (*Crystalline Investments Ltd. v. Domgroup Ltd.*, 2004 SCC 3, [2004] 1 S.C.R. 60 (S.C.C.), at para. 43). The Court of Appeal therefore did not err in finding that at the end of a *CCAA* liquidation proceeding, priorities may be determined by the *PPSA*'s scheme rather than the federal scheme set out in the *BIA*.

53 The Appellants' second argument is that an order granting priority to the plan's members on the basis of the deemed trust provided for by the Ontario legislature would be unconstitutional in that it would conflict with the order granting priority to the DIP lenders that was made under the *CCAA*. They argue that the doctrine of paramountcy resolves this conflict, as it would render the provincial law inoperative to the extent that it is incompatible with the federal law.

54 There is a preliminary question that must be addressed before determining whether the doctrine of paramountcy applies in this context. This question arises because the Court of Appeal found that although the *CCAA* court had the power to authorize a DIP charge that would supersede the deemed trust, the order in this case did not have such an effect because paramountcy had not been invoked. As a result, the priority of the deemed trust over secured creditors by virtue of s. 30(7) of the *PPSA* remained in effect, and the Plan Members' claim ranked in priority to the claim of the DIP lenders established in the *CCAA* order.

55 With respect, I cannot accept this approach to the doctrine of federal paramountcy. This doctrine resolves conflicts in the application of overlapping valid provincial and federal legislation (*Canadian Western Bank v. Alberta*, 2007 SCC 22, [2007] 2 S.C.R. 3 (S.C.C.), at paras. 32 and 69). Paramountcy is a question of law. As a result, subject to the application of the rules on the admissibility of new evidence, it can be raised even if it was not invoked in an initial proceeding.

56 A party relying on paramountcy must "demonstrate that the federal and provincial laws are in fact incompatible by establishing either that it is impossible to comply with both laws or that to apply the provincial law would frustrate the purpose of the federal law" (*Canadian Western Bank*, at para. 75). This Court has in fact applied the doctrine of paramountcy in the area of bankruptcy and insolvency to come to the conclusion that a provincial legislature cannot, through measures such as a deemed trust, affect priorities granted under federal legislation (*Husky Oil*).

57 None of the parties question the validity of either the federal provision that enables a *CCAA* court to make an order authorizing a DIP charge or the provincial provision that establishes the priority of the deemed trust. However, in considering whether the *CCAA* court has, in exercising its discretion to assess a claim, validly affected a provincial priority, the reviewing court should remind itself of the rule of interpretation stated in *Canada (Attorney General) v. Law Society (British Columbia)*, [1982] 2 S.C.R. 307 (S.C.C.) (at p. 356), and reproduced in *Canadian Western Bank* (at para. 75):

> When a federal statute can be properly interpreted so as not to interfere with a provincial statute, such an interpretation is to be applied in preference to another applicable construction which would bring about a conflict between the two statutes.

58 In the instant case, the *CCAA* judge, in authorizing the DIP charge, did not consider the fact that the Salaried Plan's members had a claim that was protected by a deemed trust, nor did he explicitly note that ordinary creditors, such as the Executive Plan's members, had not received notice of the DIP loan motion. However, he did consider factors that were relevant to the remedial objective of the *CCAA* and found that Indalex had in fact demonstrated that the *CCAA*'s purpose would be frustrated without the DIP charge. It will be helpful to quote the reasons he gave on April 17, 2009 in authorizing the DIP charge ((2009), 52 C.B.R. (5th) 61 (Ont. S.C.J. [Commercial List])):

> (a) the Applicants are in need of the additional financing in order to support operations during the period of a going concern restructuring;
>
> (b) there is a benefit to the breathing space that would be afforded by the DIP Financing that will permit the Applicants to identify a going concern solution;
>
> (c) there is no other alternative available to the Applicants for a going concern solution;
>
> (d) a stand-alone solution is impractical given the integrated nature of the business of Indalex Canada and Indalex U.S.;

(e) given the collateral base of Indalex U.S., the Monitor is satisfied that it is unlikely that the Post-Filing Guarantee with respect to the U.S. Additional Advances will ever be called and the Monitor is also satisfied that the benefits to stakeholders far outweighs the risk associated with this aspect of the Post-Filing Guarantee;

(f) the benefit to stakeholders and creditors of the DIP Financing outweighs any potential prejudice to unsecured creditors that may arise as a result of the granting of super-priority secured financing against the assets of the Applicants;

(g) the Pre-Filing Security has been reviewed by counsel to the Monitor and it appears that the unsecured creditors of the Canadian debtors will be in no worse position as a result of the Post-Filing Guarantee than they were otherwise, prior to the CCAA filing, as a result of the limitation of the Canadian guarantee set forth in the draft Amended and Restated Initial Order ...; and

(h) the balancing of the prejudice weighs in favour of the approval of the DIP Financing. [para. 9]

59 Given that there was no alternative for a going-concern solution, it is difficult to accept the Court of Appeal's sweeping intimation that the DIP lenders would have accepted that their claim ranked below claims resulting from the deemed trust. There is no evidence in the record that gives credence to this suggestion. Not only is it contradicted by the *CCAA* judge's findings of fact, but case after case has shown that "the priming of the DIP facility is a key aspect of the debtor's ability to attempt a workout" (J. P. Sarra, *Rescue! The Companies' Creditors Arrangement Act* (2007), at p. 97). The harsh reality is that lending is governed by the commercial imperatives of the lenders, not by the interests of the plan members or the policy considerations that lead provincial governments to legislate in favour of pension fund beneficiaries. The reasons given by Morawetz J. in response to the first attempt of the Executive Plan's members to reserve their rights on June 12, 2009 are instructive. He indicated that any uncertainty as to whether the lenders would withhold advances or whether they would have priority if advances were made did "not represent a positive development". He found that, in the absence of any alternative, the relief sought was "necessary and appropriate" (2009 CanLII 37906 [2009 CarswellOnt 4263 (Ont. S.C.J.)], at paras. 7 and 8).

60 In this case, compliance with the provincial law necessarily entails defiance of the order made under federal law. On the one hand, s. 30(7) of the *PPSA* required a part of the proceeds from the sale related to assets described in the provincial statute to be paid to the plan's administrator before other secured creditors were paid. On the other hand, the Amended Initial Order provided that the DIP charge ranked in priority to "all other security interests, trusts, liens, charges and encumbrances, statutory or otherwise" (para. 45). Granting priority to the DIP lenders subordinates the claims of other stakeholders, including the Plan Members. This court-ordered priority based on the *CCAA* has the same effect as a statutory priority. The federal and provincial laws are inconsistent, as they give rise to different, and conflicting, orders of priority. As a result of the application of the doctrine of federal paramountcy, the DIP charge supersedes the deemed trust.

C. Did Indalex Have Fiduciary Obligations to the Plan Members?

61 The fact that the DIP financing charge supersedes the deemed trust or that the interests of the Executive Plan's members are not protected by the deemed trust does not mean that Plan Members have no right to receive money out of the reserve fund. What remains to be considered is whether an equitable remedy, which could override all priorities, can and should be granted for a breach by Indalex of a fiduciary duty.

62 The first stage of a fiduciary duty analysis is to determine whether and when fiduciary obligations arise. The Court has recognized that there are circumstances in which a pension plan administrator has fiduciary obligations to plan members both at common law and under statute (*Burke v. Hudson's Bay Co.*, 2010 SCC 34, [2010] 2 S.C.R. 273 (S.C.C.), at para. 41). It is clear that the indicia of a fiduciary relationship attach in this case between the Plan Members and Indalex as plan administrator. Sun Indalex and the Monitor do not dispute this proposition.

63 However, Sun Indalex and the Monitor argue that the employer has a fiduciary duty only when it acts as plan administrator — when it is wearing its administrator's "hat". They contend that, outside the plan administration context, when directors make decisions in the best interests of the corporation, the employer is wearing solely its "corporate hat". On this view, decisions made by the employer in its corporate capacity are not burdened by the corporation's fiduciary obligations to its pension plan members and, consequently, cannot be found to conflict with plan members' interests. This is not the correct approach to take in determining the scope of the fiduciary obligations of an employer acting as plan administrator.

64 Only persons or entities authorized by the *PBA* can act as plan administrators (ss. 1(1) and 8(1)(a)). The employer is one of them. A corporate employer that chooses to act as plan administrator accepts the fiduciary obligations attached to that function. Since the directors of a corporation also have a fiduciary duty to the corporation, the fact that the corporate employer can act as administrator of a pension plan means that s. 8(1)(a) of the *PBA* is based on the assumption that not all decisions taken by directors in managing a corporation will result in conflict with the corporation's duties to the plan's members. However, the corporate employer must be prepared to resolve conflicts where they arise. Reorganization proceedings place considerable burdens on any debtor, but these burdens do not release an employer that acts as plan administrator from its fiduciary obligations.

65 Section 22(4) of the *PBA* explicitly provides that a plan administrator must not permit its own interest to conflict with its duties in respect of the pension fund. Thus, where an employer's own interests do not converge with those of the plan's members, it must ask itself whether there is a potential conflict and, if so, what can be done to resolve the conflict. Where interests do conflict, I do not find the two hats metaphor helpful. The solution is not to determine whether a given decision can be classified as being related to either the management of the corporation or the administration of the pension plan. The employer may well take a sound management decision, and yet do something that harms the interests of the plan's members. An employer acting as a plan administrator is not permitted to disregard its fiduciary obligations to plan members and favour the competing interests of the corporation on the basis that it is wearing a "corporate hat". What is important is to consider the consequences of the decision, not its nature.

66 When the interests the employer seeks to advance on behalf of the corporation conflict with interests the employer has a duty to preserve as plan administrator, a solution must be found to ensure that the plan members' interests are taken care of. This may mean that the corporation puts the members on notice, or that it finds a replacement administrator, appoints representative counsel or finds some other means to resolve the conflict. The solution has to fit the problem, and the same solution may not be appropriate in every case.

67 In the instant case, Indalex's fiduciary obligations as plan administrator did in fact conflict with management decisions that needed to be taken in the best interests of the corporation. Indalex had a number of responsibilities as plan administrator. For example, s. 56(1) of the *PBA* required it to ensure that contributions were paid when due. Section 56(2) required that it notify the Superintendent if contributions were not paid when due. It was also up to Indalex under s. 59 to commence proceedings to obtain payment of contributions that were due but not paid. Indalex, as an employer, paid all the contributions that were due. However, its insolvency put contributions that had accrued to the date of the wind up at risk. In an insolvency context, the administrator's claim for contributions that have accrued is a provable claim.

68 In the context of this case, the fact that Indalex, as plan administrator, might have to claim accrued contributions from itself means that it would have to simultaneously adopt conflicting positions on whether contributions had accrued as of the date of liquidation and whether a deemed trust had arisen in respect of wind-up deficiencies. This is indicative of a clear conflict between Indalex's interests and those of the Plan Members. As soon as it saw, or ought to have seen, a potential for conflict, Indalex should have taken steps to ensure that the interests of the Plan Members were protected. It did not do so. On the contrary, it contested the position the Plan Members advanced. At the very least, Indalex breached its duty to avoid conflicts of interest (s. 22(4), *PBA*).

69 Since the Plan Members seek an equitable remedy, it is important to identify the point at which Indalex should have moved to ensure that their interests were safeguarded. Before doing so, I would stress that factual contexts are needed to analyse conflicts between interests, and that it is neither necessary nor useful to attempt to map out all the situations in which conflicts may arise.

70 As I mentioned above, insolvency puts the employer's contributions at risk. This does not mean that the decision to commence insolvency proceedings entails on its own a breach of a fiduciary obligation. The commencement of insolvency proceedings in this case on April 3, 2009 in an emergency situation was explained by Timothy R. J. Stubbs, the then-president of Indalex. The company was in default to its lender, it faced legal proceedings for unpaid bills, it had received a termination notice effective April 6 from its insurers, and suppliers had stopped supplying on credit. These circumstances called for urgent action by Indalex lest a creditor start bankruptcy proceedings and in so doing jeopardize ongoing operations and jobs. Several facts lead me to conclude that the stay sought in this case did not, in and of itself, put Indalex in a conflict of interest.

71 First, a stay operates only to freeze the parties' rights. In most cases, stays are obtained *ex parte*. One of the reasons for refraining from giving notice of the initial stay motion is to avert a situation in which creditors race to court to secure benefits that they would not enjoy in insolvency. Subjecting as many creditors as possible to a single process is seen as a way to treat all of them more equitably. In this context, plan members are placed on the same footing as the other creditors and have no special entitlement to notice. Second, one of the conclusions of the order Indalex sought was that it was to be served on all creditors, with a few exceptions, within 10 days. The notice allowed any interested party to apply to vary the order. Third, Indalex was permitted to pay all pension benefits. Although the order excluded special solvency payments, no ruling was made at that point on the merits of the creditors' competing claims, and a stay gave the Plan Members the possibility of presenting their arguments on the deemed trust rather than losing it altogether as a result of a bankruptcy proceeding, which was the alternative.

72 Whereas the stay itself did not put Indalex in a conflict of interest, the proceedings that followed had adverse consequences. On April 8, 2009, Indalex brought a motion to amend and restate the initial order in order to apply for DIP financing. This motion had been foreseen. Mr. Stubbs had mentioned in the affidavit he signed in support of the initial order that the lenders had agreed to extend their financing, but that Indalex would be in need of authorization in order to secure financing to continue its operations. However, the initial order had not yet been served on the Plan Members as of April 8. Short notice of the motion was given to the USW rather than to all the individual Plan Members, but the USW did not appear. The Plan Members were quite simply not represented on the motion to amend the initial stay order requesting authorization to grant the DIP charge.

73 In seeking to have a court approve a form of financing by which one creditor was granted priority over all other creditors, Indalex was asking the *CCAA* court to override the Plan Members' priority. This was a case in which Indalex's directors permitted the corporation's best interests to be put ahead of those of the Plan Members. The directors may have fulfilled their fiduciary duty to Indalex, but they placed Indalex in the position of failing to fulfil its obligations as plan administrator. The corporation's interest was to seek the best possible avenue to survive in an insolvency context. The pursuit of this interest was not compatible with the plan administrator's duty to the Plan Members to ensure that all contributions were paid into the funds. In the context of this case, the plan administrator's duty to the Plan Members meant, in particular, that it should at least have given them the opportunity to present their arguments. This duty meant, at the very least, that they were entitled to reasonable notice of the DIP financing motion. The terms of that motion, presented without appropriate notice, conflicted with the interests of the Plan Members. Because Indalex supported the motion asking that a priority be granted to its lender, it could not at the same time argue for a priority based on the deemed trust.

74 The Court of Appeal found a number of other breaches. I agree with Cromwell J. that none of the subsequent proceedings had a negative impact on the Plan Members' rights. The events that occurred, in particular the second DIP financing motion and the sale process, were predictable and, in a way, typical of reorganizations. Notice was given in all

cases. The Plan Members were represented by able counsel. More importantly, the court ordered that funds be reserved and that a full hearing be held to argue the issues.

75 The Monitor and George Miller, Indalex U.S.'s trustee in bankruptcy, argue that the Plan Members should have appealed the Amended Initial Order authorizing the DIP charge, and were precluded from subsequently arguing that their claim ranked in priority to that of the DIP lenders. They take the position that the collateral attack doctrine bars the Plan Members from challenging the DIP financing order. This argument is not convincing. The Plan Members did not receive notice of the motion to approve the DIP financing. Counsel for the Executive Plan's members presented the argument of that plan's members at the first opportunity and repeated it each time he had an occasion to do so. The only time he withdrew their opposition was at the hearing of the motion for authorization to increase the DIP loan amount after being told that the only purpose of the motion was to increase the amount of the authorized loan. The *CCAA* judge set a hearing date for the very purpose of presenting the arguments that Indalex, as plan administrator, could have presented when it requested the amendment to the initial order. It cannot now be argued, therefore, that the Plan Members are barred from defending their interests by the collateral attack doctrine.

D. Would an Equitable Remedy Be Appropriate in the Circumstances?

76 The definition of "secured creditor" in s. 2 of the *CCAA* includes a trust in respect of the debtor's property. The Amended Initial Order (at para. 45) provided that the DIP lenders' claims ranked in priority to all trusts, "statutory or otherwise". Indalex U.S. was subrogated to the DIP lenders' claim by operation of the guarantee in the DIP lending agreement.

77 Counsel for the Executive Plan's members argues that the doctrine of equitable subordination should apply to subordinate Indalex U.S.'s subrogated claim to those of the Plan Members. This Court discussed the doctrine of equitable subordination in *Canada Deposit Insurance Corp. v. Canadian Commercial Bank*, [1992] 3 S.C.R. 558 (S.C.C.), but did not endorse it, leaving it for future determination (p. 609). I do not need to endorse it here either. Suffice to say that there is no evidence that the lenders committed a wrong or that they engaged in inequitable conduct, and no party has contested the validity of Indalex U.S.'s payment of the US$10 million shortfall.

78 This leaves the constructive trust remedy ordered by the Court of Appeal. It is settled law that proprietary remedies are generally awarded only with respect to property that is directly related to a wrong or that can be traced to such property. I agree with my colleague Cromwell J. that this condition is not met in the case at bar. I adopt his reasoning on this issue.

79 Moreover, I am of the view that it was unreasonable for the Court of Appeal to reorder the priorities in this case. The breach of fiduciary duty identified in this case is, in substance, the lack of notice. Since the Plan Members were allowed to fully argue their case at a hearing specifically held to adjudicate their rights, the *CCAA* court was in a position to fully appreciate the parties' positions.

80 It is difficult to see what gains the Plan Members would have secured had they received notice of the motion that resulted in the Amended Initial Order. The *CCAA* judge made it clear, and his finding is supported by logic, that there was no alternative to the DIP loan that would allow for the sale of the assets on a going-concern basis. The Plan Members presented no evidence to the contrary. They rely on conjecture alone. The Plan Members invoke other cases in which notice was given to plan members and in which the members were able to fully argue their positions. However, in none of those cases were plan members able to secure any additional benefits. Furthermore, the Plan Members were allowed to fully argue their case. As a result, even though Indalex breached its fiduciary duty to notify the Plan Members of the motion that resulted in the Amended Initial Order, their claim remains subordinate to that of Indalex U.S.

IV. Conclusion

81 There are good reasons for giving special protection to members of pension plans in insolvency proceedings. Parliament considered doing so before enacting the most recent amendments to the *CCAA*, but chose not to (*An Act*

to amend the Bankruptcy and Insolvency Act, the Companies' Creditors Arrangement Act, the Wage Earner Protection Program Act and chapter 47 of the Statutes of Canada, 2005, S.C. 2007, c. 36, in force September 18, 2009, SI/2009-68; see also Bill C-501, *An Act to amend the Bankruptcy and Insolvency Act and other Acts (pension protection)*, 3rd Sess., 40th Parl., March 24, 2010 (subsequently amended by the Standing Committee on Industry, Science and Technology, March 1, 2011)). A report of the Standing Senate Committee on Banking, Trade and Commerce gave the following reasons for this choice:

> Although the Committee recognizes the vulnerability of current pensioners, we do not believe that changes to the BIA regarding pension claims should be made at this time. Current pensioners can also access retirement benefits from the Canada/Quebec Pension Plan, and the Old Age Security and Guaranteed Income Supplement programs, and may have private savings and Registered Retirement Savings Plans that can provide income for them in retirement. The desire expressed by some of our witnesses for greater protection for pensioners and for employees currently participating in an occupational pension plan must be balanced against the interests of others. As we noted earlier, insolvency — at its essence — is characterized by insufficient assets to satisfy everyone, and choices must be made.
>
> The Committee believes that granting the pension protection sought by some of the witnesses would be sufficiently unfair to other stakeholders that we cannot recommend the changes requested. For example, we feel that super priority status could unnecessarily reduce the moneys available for distribution to creditors. In turn, credit availability and the cost of credit could be negatively affected, and all those seeking credit in Canada would be disadvantaged. *Debtors and Creditors Sharing the Burden: A Review of the Bankruptcy and Insolvency Act and the Companies' Creditors Arrangement Act* (2003), at p. 98; see also p. 88.)

82 In an insolvency process, a *CCAA* court must consider the employer's fiduciary obligations to plan members as their plan administrator. It must grant a remedy where appropriate. However, courts should not use equity to do what they wish Parliament had done through legislation.

83 In view of the fact that the Plan Members were successful on the deemed trust and fiduciary duty issues, I would not order costs against them either in the Court of Appeal or in this Court.

84 I would therefore allow the main appeals without costs in this Court, set aside the orders made by the Court of Appeal, except with respect to orders contained in paras. 9 and 10 of the judgment of the Court of Appeal in the former executive members' appeal and restore the orders of Campbell J. dated February 18, 2010. I would dismiss USW's costs appeal without costs.

***Cromwell J.*:**

I. Introduction

85 When a business becomes insolvent, many interests are at risk. Creditors may not be able to recover their debts, investors may lose their investments and employees may lose their jobs. If the business is the sponsor of an employee pension plan, the benefits promised by the plan are not immune from that risk. The circumstances leading to these appeals show how that risk can materialize. Pension plans and creditors find themselves in a zero-sum game with not enough money to go around. At a very general level, this case raises the issue of how the law balances the interests of pension plan beneficiaries with those of other creditors.

86 Indalex Limited, the sponsor and administrator of employee pension plans, became insolvent and sought protection from its creditors under the *Companies' Creditors Arrangement Act*, R.S.C. 1985, c. C-36 ("*CCAA*"). Although all current contributions were up to date, the company's pension plans did not have sufficient assets to fulfill the pension promises made to their members. In a series of court-sanctioned steps, which were judged to be in the best interests of all stakeholders, the company borrowed a great deal of money to allow it to continue to operate. The parties injecting the operating money were given a super priority over the claims by other creditors. When the business was sold, thereby

preserving hundreds of jobs, there was a shortfall between the sale proceeds and the debt. The pension plan beneficiaries thus found themselves in a dispute about the priority of their claims. The appellant, Sun Indalex Finance LLC, claimed it had priority by virtue of the super priority granted in the *CCAA* proceedings. The trustee in bankruptcy of the U.S. Debtors (George Miller) and the Monitor (FTI Consulting) joined in the appeal. The plan beneficiaries claimed that they had priority by virtue of a statutory deemed trust under the *Pension Benefits Act*, R.S.O. 1990, c. P.8 ("*PBA*"), and a constructive trust arising from the company's alleged breaches of fiduciary duty.

87 The Ontario Court of Appeal sided with the plan beneficiaries and Sun Indalex, the trustee in bankruptcy and the Monitor all appeal. The specific legal points in issue are:

A. Did the Court of Appeal err in finding that the statutory deemed trust provided for in s. 57(4) of the *PBA* applied to the salaried plan's wind-up deficiency?

B. Did the Court of Appeal err in finding that Indalex breached the fiduciary duties it owed to the pension plan beneficiaries as the plans' administrator and in imposing a constructive trust as a remedy?

C. Did the Court of Appeal err in concluding that the super priority granted in the *CCAA* proceedings did not have priority by virtue of the doctrine of federal paramountcy?

D. Did the Court of Appeal err in its cost endorsement respecting the United Steelworkers ("USW")?

88 My view is that the deemed trust does not apply to the disputed funds, and even if it did, the super priority would override it. I conclude that the corporation failed in its duty to the plan beneficiaries as their administrator and that the beneficiaries ought to have been afforded more procedural protections in the *CCAA* proceedings. However, I also conclude that the Court of Appeal erred in using the equitable remedy of a constructive trust to defeat the super priority ordered by the *CCAA* judge. I would therefore allow the main appeals.

II. Facts and Proceedings Below

A. Overview

89 These appeals concern claims by pension fund members for amounts owed to them by the plans' sponsor and administrator which became insolvent.

90 Indalex Limited is the parent company of three non-operating Canadian companies. I will refer to both Indalex Limited individually and to the group of companies collectively as "Indalex", unless the context requires further clarity. Indalex Limited is the wholly owned subsidiary of its U.S. parent, Indalex Holding Corp. which owned and conducted related operations in the U.S. through its U.S. subsidiaries which I will refer to as the "U.S. debtors".

91 In late March and early April of 2009, Indalex and the U.S. debtors were insolvent and sought protection from their creditors, the former under the Canadian *CCAA*, and the latter under the United States Bankruptcy Code, 11 U.S.C., Chapter 11. The dispute giving rise to these appeals concern the priority granted to lenders in the *CCAA* process for funds advanced to Indalex and whether that priority overrides the claims of two of Indalex's pension plans for funds owed to them.

92 Indalex was the sponsor and administrator of two registered pension plans relevant to these proceedings, one for salaried employees and the other for executive employees. At the time of seeking *CCAA* protection, the salaried plan was being wound up (with a wind-up date of December 31, 2006) and was estimated to have a wind-up deficiency (as of the end of 2007) of roughly $2.252 million. The executive plan, while it was not being wound up, had been closed to new members since 2005. It was estimated to have a deficiency of roughly $2.996 million on wind up. At the time the *CCAA* proceedings were started, all regular current service contributions had been made to both plans.

93 Shortly after Indalex received *CCAA* protection, the *CCAA* judge authorized the company to enter into debtor in possession ("DIP") financing in order to allow it to continue to operate. The court granted the DIP lenders, a syndicate of banks, a "super priority" over "all other security interests, trusts, liens, charges and encumbrances, statutory or otherwise": initial order, at para. 35 (joint A.R., vol. I, at pp. 123-24). Repayment of these amounts was guaranteed by the U.S. debtors.

94 Ultimately, with the approval of the *CCAA* court, Indalex sold its business; the purchaser did not assume pension liabilities. A reserve fund was established by the *CCAA* Monitor to answer any outstanding claims. The proceeds of the sale were not sufficient to pay back the DIP lenders and so the U.S. debtors, as guarantors, paid the shortfall and stepped into the shoes of the DIP lenders in terms of priority.

95 The appellant Sun Indalex is a pre-*CCAA* secured creditor of both Indalex and the U.S. debtors. It claims the reserve fund on the basis that the US$10.75 million paid by the guarantors would otherwise have been available to Sun Indalex as a secured creditor of the U.S. debtors in the U.S. bankruptcy proceedings. The respondent plan beneficiaries claim the reserve fund on the basis that they have a wind-up deficiency which is covered by a deemed trust created by s. 57(4) of the *PBA*. This deemed trust includes "an amount of money equal to employer contributions *accrued to the date of the wind up but not yet due* under the plan or regulations" (s. 57(4)). They also claim the reserve fund on the basis of a constructive trust arising from Indalex's failure to live up to its fiduciary duties as plan administrator.

96 The reserve fund is not sufficient to pay back both Sun Indalex and the pension plans and so the main question on the main appeals is which of the creditors is entitled to priority for their respective claims.

97 The judge at first instance rejected the plan beneficiaries' deemed trust arguments and held that, with respect to the wind-up deficiency, the plan beneficiaries were unsecured creditors, ranking behind those benefitting from the "super priority" and secured creditors (2010 ONSC 1114, 79 C.C.P.B. 301 (Ont. S.C.J. [Commercial List])). The Court of Appeal reversed this ruling and held that pension plan deficiencies were subject to deemed and constructive trusts which had priority over the DIP financing and over other secured creditors (2011 ONCA 265, 104 O.R. (3d) 641 (Ont. C.A.)). Sun Indalex, the trustee in bankruptcy and the Monitor appeal.

B. Indalex's CCAA Proceedings

(1) The Initial Order (Joint A.R., vol. I, at p. 112)

98 As noted earlier, Indalex was in financial trouble and, on April 3, 2009, sought and obtained protection from its creditors under the *CCAA*. The order (which I will refer to as the initial order) also contained directions for service on creditors and others: paras. 39-41. The order also contained a so-called "comeback clause" allowing any interested party to apply for a variation of the order, provided that that party served notice on any other party likely to be affected by any such variation: para. 46. It is common ground that the plan beneficiaries did not receive notice of the application for the initial order but the *CCAA* court nevertheless approved the method of and time for service. Full particulars of the deficiencies in the pension plans were before the court in the motion material and the initial order addressed payment of the employer's current service pension contributions.

(2) The DIP Order (Joint A.R., vol. I, at p. 129)

99 On April 8, 2009, in what I will refer to as the DIP order, the *CCAA* judge, Morawetz J., authorized Indalex to borrow funds pursuant to a DIP credit agreement. The judge ordered among many other things, the following:

- He approved abridged notice: para. 1;

- He allowed Indalex to continue making current service contributions to the pension plans, but not special payments: paras. 7(a) and 9(b);

• He barred all proceedings against Indalex, except by consent of Indalex and the Monitor or leave of the court, until May 1, 2009: para. 15;

• He granted the DIP lenders a so-called super priority:

> THIS COURT ORDERS that each of the Administration Charge, the Directors' Charge and <u>the DIP Lenders Charge</u> (all as constituted and defined herein) shall constitute a charge on the Property and such Charges <u>shall rank in priority to all other security interests, trust, liens, charges and encumbrances, statutory or otherwise</u> (collectively, "Encumbrances") in favour of any Person. [Emphasis added; para. 45.]

• He required Indalex to send notice of the order to all known creditors, other than employees and creditors to which Indalex owed less than $5,000 and stated that Indalex and the Monitor were "at liberty" to serve the Initial Order to interested parties: paras. 49-50.

100 In his endorsement for the DIP order, Morawetz J. found that "there is no other alternative available to the Applicants [Indalex] for a going concern solution" and that DIP financing was necessary: (2009), 52 C.B.R. (5th) 61 (Ont. S.C.J. [Commercial List]), at para. 9(c). He noted that the Monitor in its report was of the view that approval of the DIP agreement was both necessary and in the best interests of Indalex and its stakeholders, including its creditors, employees, suppliers and customers: paras. 14-16.

101 The USW, which represented some of the members of the salaried plan, was served with notice of the motion that led to the DIP order, but did not appear. Morawetz J. specifically ordered as follows with regard to service:

> THIS COURT ORDERS that the time for service of the Notice of Application and the Application Record is hereby abridged so that this Application is properly returnable today and hereby dispenses with further service thereof. [DIP order, at para. 1]

(3) The DIP Extension Order (Joint A.R., vol. I, at p. 156)

102 On June 12, 2009, Morawetz J. heard and granted an application by Indalex to allow them to borrow approximately $5 million more from the DIP lenders, thus raising the allowed total to US$29.5 million.

103 Counsel for the former executives received the motion material the night before. Counsel for USW was also served with notice. At the motion, the former executives (along with second priority secured noteholders) sought to "reserve their rights with respect to the relief sought": 2009 CanLII 37906 [2009 CarswellOnt 4263 (Ont. S.C.J.)], at para. 4. Morawetz J. wrote that any "reservation of rights" would create uncertainty for the DIP lenders with regard to priority, and may prevent them from extending further advances. Moreover, the parties had presented no alternative to increased DIP financing, which was both "necessary and appropriate" and would, it was to be hoped, "improve the position of the stakeholders": paras. 5-9.

(4) The Bidding Order ((2009), 79 C.C.P.B. 101 (Ont. S.C.J. [Commercial List]))

104 On July 2, 2009, Indalex brought a motion for approval of proposed bidding procedures for Indalex's assets. Morawetz J. decided that a stalking horse bid by SAPA Holding AB ("SAPA") for Indalex's assets could count as a qualifying bid. Counsel on behalf of the members of the executive plan appeared, with the concern that "their position and views have not been considered in this process": para. 8. In his decision, Morawetz J. decided that these arguments could be dealt with later, at a sale approval motion: para. 10. The judge said:

> The position facing the retirees is unfortunate. The retirees are currently not receiving what they bargained for. <u>However, reality cannot be ignored and the nature of the Applicants' insolvency is such that there are insufficient assets to meet its liabilities. The retirees are not alone in this respect. The objective of these proceedings is to achieve the best possible outcome for the stakeholders.</u>

[Emphasis added; para. 9.]

(5) The Sale Approval Order (Joint A.R., vol. I, at p. 166)

105 On July 20, 2009, Indalex brought two motions before Campbell J.

106 The first motion sought approval for the sale of Indalex's assets as a going concern to SAPA. SAPA was not to assume any pension liabilities. Campbell J. granted an order approving this sale.

107 The second motion sought approval for an interim distribution of the sale proceeds to the DIP lenders. Counsel on behalf of the executive plan members and the USW, representing some of the salaried employees, objected to the planned distribution of the sale proceeds on grounds that a statutory deemed trust applied to the deficiencies in their plans and that Indalex had breached fiduciary duties that it owed to them. Campbell J. ordered the Monitor to pay the DIP agent from the sale proceeds, but also ordered the Monitor to set up a reserve fund in an amount sufficient to answer, among other things, the claims of the plan beneficiaries pending resolution of those matters. Campbell J. ordered that the U.S. debtors be subrogated to the DIP lenders to the extent that the U.S. debtors were required under the guarantee to satisfy the DIP lenders' claims: para. 14.

(6) The Sale and Distribution of Funds

108 SAPA bought Indalex's assets on July 31, 2009. Taking the reserve fund into account, the sale did not produce sufficient funds to repay the DIP lenders in full and so the U.S. debtors paid US$10,751,247 as guarantor to the DIP lenders: C.A. reasons, at para. 65.

(7) The Order Under Appeal

109 On August 28, 2009, Campbell J. heard claims by the USW (appearing on behalf of some members of the salaried plan) and counsel appearing on behalf of the executive plan members that the wind-up deficiency was subject to a deemed trust. He rejected these claims in a written decision on February 18, 2010. He decided that the s. 57(4) *PBA* deemed trust did not apply to wind-up deficiencies. The executive plan had not been wound up, and therefore there was no wind-up deficiency to be the subject of the deemed trust. As for the salaried plan, Campbell J. held that the windup deficiency was not an obligation that had "accrued to the date of the wind up" and as a result did not fall within the terms of the s. 57(4) deemed trust.

110 Indalex had asked for the stay granted under the initial order to be lifted so that it could assign itself into bankruptcy. Because he did not find a deemed trust, Campbell J. did not feel that he needed to decide on the motion to lift the stay.

(8) The Decision of the Ontario Court of Appeal

111 The Ontario Court of Appeal allowed an appeal from the decision of Campbell J.

112 Writing for a unanimous panel, Gillese J.A. decided that the s. 57(4) deemed trust is applicable to wind-up deficiencies. She took the view that s. 57(4)'s reference to "employer contributions accrued to the date of the wind up but not yet due" included all amounts that the employer owed on the wind-up of its pension plan: para. 101. In particular, she concluded that the deemed trust applied to the wind-up deficiency in the salaried plan. Gillese J.A. declined, however, to decide whether the deemed trust also applied to deficiencies in the executive plan, which had not been wound up by the relevant date: paras. 110-12. A decision on this latter point was unnecessary given her finding on the applicability of a constructive trust in this case.

113 Gillese J.A. found that the super priority provided for in the DIP order did not trump the deemed trust over the salaried plan's wind-up deficiency. Morawetz J. had not "invoked" the issue of paramountcy or made an explicit

finding that the requirements of federal law required that the provincially created deemed trust must be overridden: paras. 178-79. Gillese J.A. also took the view that this Court's decision in *Ted Leroy Trucking Ltd., Re*, 2010 SCC 60, [2010] 3 S.C.R. 379 (S.C.C.), did not mean that provincially created priorities that would be ineffective under the *Bankruptcy and Insolvency* Act, R.S.C. 1985, c. B-3 ("BIA"), were also ineffective under the *CCAA*: paras. 185-96. The deemed trust therefore ranked ahead of the DIP security.

114 In addition to her findings regarding deemed trusts, Gillese J.A. granted the plan beneficiaries a constructive trust over the amount of the reserve fund on the ground that Indalex, as pension plan administrator, had breached fiduciary duties that it owed to the plan beneficiaries during the *CCAA* proceedings.

115 She held that as a plan administrator who was also an employer, Indalex had fiduciary duties both to the plan beneficiaries and to the corporation: para. 129. In her view, Indalex was subject to both sets of duties throughout the *CCAA* proceedings and it had breached its duties to the plan beneficiaries in several ways. While Indalex had the right to initiate *CCAA* proceedings, this action made the plan beneficiaries vulnerable and therefore triggered its fiduciary obligations as plan administrator: paras. 132-33. Gillese J.A. enumerated the many ways in which she thought Indalex subsequently failed as plan administrator: it did nothing in the *CCAA* proceedings to fund the deficit in the underfunded plans; it applied for *CCAA* protection without notice to the beneficiaries; it obtained DIP financing on the condition that DIP lenders be granted a super priority over "statutory trusts"; it obtained this financing without notice to the plan beneficiaries; it sold its assets knowing the purchaser was not taking over the plans; and it attempted to enter into voluntary bankruptcy, which would defeat any deemed trust claims the beneficiaries might have asserted: para. 139. Gillese J.A. also noted that throughout the *CCAA* proceedings Indalex was in a conflict of interest because it was acting for both the corporation and the beneficiaries.

116 Indalex's failure to live up to its fiduciary duties meant that the plan beneficiaries were entitled to a constructive trust over the amount of the reserve fund: para. 204. Since the beneficiaries had been wronged by Indalex, and the U.S. debtors were not, with respect to Indalex, an "arm's length innocent third party" the appropriate response was to grant the beneficiaries a constructive trust: para. 204. Her conclusion on this point applied equally to the salaried and executive plans.

III. Analysis

A. First Issue: Did the Court of Appeal Err in Finding That the Deemed Statutory Trust Provided for in Section 57(4) of the PBA Applied to the Salaried Plan's Wind-up Deficiency?

(1) Introduction

117 The main issue addressed here concerns whether the statutory deemed trust provided for in s. 57(4) of the *PBA* applies to wind-up deficiencies, the payment of which is provided for in s. 75(1)(b).

118 The deemed trust created by s. 57(4) applies to "employer contributions accrued to the date of the wind-up but not yet due under the plan or regulations". Thus, to be subject to the deemed trust, the pension plan must be wound up and the amounts in question must meet three requirements. They must be (1) "employer contributions", (2) "accrued to the date of the wind-up" and (3) "not yet due". A wind-up deficiency arises "[w]here a pension plan is wound up": s. 75(1). I agree with my colleagues that there can be no deemed trust for the executive plan, because that plan had not been wound up at the relevant date. What follows, therefore, is relevant only to the salaried plan.

119 The wind-up deficiency payments are "employer contributions" which are "not yet due" as of the date of wind-up within the meaning of the *PBA*. The main issue before us, therefore, boils down to the narrow interpretative question of whether the wind-up deficiency described in s. 75(1)(b) is "accrued to the date of the windup".

120 Campbell J. at first instance found that it was not, while the Court of Appeal reached the opposite conclusion. In essence, the Court of Appeal reasoned that the deemed trust in s. 57(4) "applies to all employer contributions that

are required to be made pursuant to s. 75", that is, to "all amounts owed by the employer on the wind-up of its pension plan": para. 101.

121 I respectfully disagree with the Court of Appeal's conclusion for three main reasons. First, the most plausible grammatical and ordinary sense of the words "accrued to the date of the wind up" is that the amounts referred to are precisely ascertained immediately before the effective date of the plan's wind-up. The wind-up deficiency only arises upon wind-up and it is neither ascertained nor ascertainable on the date fixed for wind-up. Second, the broader statutory context reinforces this view: the language of the deemed trusts in s. 57(3) and (4) is virtually exactly repeated in s. 75(1)(a), suggesting that both deemed trusts refer to the liability on wind-up referred to in s. 75(1)(a) and not to the further and distinct wind-up deficiency liability created under s. 75(1)(b). Finally, the legislative evolution and history of these provisions show, in my view, that the legislature never intended to include the wind-up deficiency in a statutory deemed trust.

122 Before turning to the precise interpretative issue, it will be helpful to provide some context about the employer's wind-up obligations and the deemed trust provisions that are the subject of this dispute.

(2) Employer Obligations on Wind Up

123 A "wind up" means that the plan is terminated and the plan assets are distributed: see *PBA*, s. 1(1), definition of "wind up". The employer's liability on wind-up consists of two main components. The first is provided for in s. 75(1)(a) and includes "an amount equal to the total of all payments that, under this Act, the regulations and the pension plan, are due or that have accrued and that have not been paid into the pension fund". This liability applies to contributions that were due as at the wind-up date but does *not* include payments required by s. 75(1)(b) that arise as a result of the wind up: A. N. Kaplan, *Pension Law* (2006), at pp. 541-42. This second liability is known as the wind-up deficiency amount. The employer must pay all additional sums to the extent that the assets of the pension fund are insufficient to cover the value of all immediately vested and accelerated benefits and grow-in benefits: Kaplan, at p. 542. Without going into detail, there are certain statutory benefits that may arise only on wind-up, such as certain benefit enhancements and the potential for acceleration of pension entitlements. Thus, wind-up will usually result in additional employer liabilities over and above those arising from the obligation to pay all benefits provided for in the plan itself: see, e.g., ss. 73 and 74; Kaplan, at p. 542. As the Court of Appeal concluded, the payments provided for under s. 75(1)(a) are those which the employer had to make while the plan was ongoing, while s. 75(1)(b) refers to the employer's obligation to make up for any wind-up deficiency: paras. 90-91.

124 For convenience, the provision as it then stood is set out here.

> **75.** (1) Where a pension plan is wound up in whole or in part, the employer shall pay into the pension fund,
>
> > (a) an amount equal to the total of all payments that, under this Act, the regulations and the pension plan, are due or that have accrued and that have not been paid into the pension fund; <u>and</u>
> >
> > (b) an amount equal to the amount by which,
> >
> > > (i) the value of the pension benefits under the pension plan that would be guaranteed by the Guarantee Fund under this Act and the regulations if the Superintendent declares that the Guarantee Fund applies to the pension plan,
> > >
> > > (ii) the value of the pension benefits accrued with respect to employment in Ontario vested under the pension plan, and
> > >
> > > (iii) the value of benefits accrued with respect to employment in Ontario resulting from the application of subsection 39 (3) (50 per cent rule) and section 74,

exceed the value of the assets of the pension fund allocated as prescribed for payment of pension benefits accrued with respect to employment in Ontario.

125 While a wind up is effective as of a fixed date, a wind up is nonetheless best thought of not simply as a moment or a single event, but as a process. It begins by a triggering event and continues until all of the plan assets have been distributed. To oversimplify somewhat, the wind-up process involves the following components.

126 The assets and liabilities of the plan as of the wind-up date must be determined. As noted earlier, the precise extent of the liability, while *fixed as of that date*, will not be ascertained or ascertainable *on that date*. The extent of the liability may depend on choices open to plan beneficiaries under the plan and on the exercise by them of certain statutory rights beyond the options that would otherwise have been available under the plan itself. The plan members must be notified of the wind-up and have their entitlements and options set out for them and given an opportunity to make their choices. The plan administrator must file a wind-up report which includes a statement of the plan's assets and liabilities, the benefits payable under the terms of the plan, and the method of allocating and distributing the assets including the priorities for the payment of benefits: *PBA*, s. 70(1), and R.R.O. 1990, Reg. 909, s. 29 (the "*PBA* Regulations").

127 Benefits to members may take the form of "cash refunds, immediate or deferred annuities, transfers to registered retirement saving plans, [etc.] ... In principle, the value of these benefits is the present value of the benefits accrued to the date of plan termination": The *Mercer Pension Manual* (loose-leaf), vol. 1, at p. 10-41. That present value is an actuarial calculation performed on the basis of various assumptions including assumptions about investment return, mortality and so forth.

128 If, when the assets and liabilities are calculated, the assets are insufficient to satisfy the liabilities, the employer (i.e. the plan sponsor) must make up for any wind-up deficiency: *PBA*, s. 75(1)(b). An employer can elect to space these payments out over the course of five years: *PBA* Regulations, s. 31(2). Because these payments are based on the extent to which there is a deficit between assets in the pension plan and the benefits owed to beneficiaries, their amount varies with the market and other assumed elements of the calculation over the course of the permitted five years.

129 To take the salaried plan as an example, at the time of wind-up, all regular current service contributions had been made: C.A. reasons, at para. 33. The wind-up deficiency was initially estimated to be $1,655,200. Indalex made special wind-up payments of $709,013 in 2007 and $875,313 in 2008, but as of December 31, 2008, the wind-up deficiency was $1,795,600 — i.e. higher than it had been two years before, notwithstanding that payments of roughly $1.6 million had been made: C.A. reasons, at para. 32. Indalex made another payment of $601,000 in April 2009: C.A. reasons, at para. 32.

(3) The Deemed Trust Provisions

130 The *PBA* contains provisions whose purpose is to exempt money owing to a pension plan, and which is held or owing by the employer, from being seized or attached by the employer's other creditors: Kaplan, at p. 395. This is accomplished by creating a "deemed trust" with respect to certain pension contributions such that these amounts are held by the employer in trust for the employees or pension beneficiaries.

131 There are two deemed trusts that we must examine here, one relating to employer contributions that are *due but have not been paid* and another relating to employer contributions *accrued but not due*. This second deemed trust is the one in issue here, but it is important to understand how the two fit together.

132 The deemed trust relating to employer contributions "due and not paid" is found in s. 57(3). The *PBA* and *PBA* regulations contain many provisions relating to contributions required by employers, the due dates for which are specified. Briefly, the required contributions are these.

133 When a pension is ongoing, employers need to make regular current service cost contributions. These are made monthly, within 30 days after the month to which they relate: *PBA* Regulations, s. 4(4)3. There are also special payments,

which relate to deficiencies between a pension plan's assets and liabilities. There are "going-concern" deficiencies and "solvency" deficiencies, the distinction between which is unimportant for the purposes of these appeals. A plan administrator must regularly file actuarial reports, which may disclose deficiencies: *PBA* Regulations, s. 14. Where there is a going-concern deficiency the employer must make equal monthly payments over a 15-year period to rectify it: *PBA* Regulations, s. 5(1)(b). Where there is a solvency deficiency, the employer must make equal monthly payments over a five-year period to rectify it: *PBA* Regulations, s. 5(1)(e). Once these regular or special payments become due but have not been paid, they are subject to the s. 57(3) deemed trust.

134 I turn next to the s. 57(4) deemed trust, which gives rise to the question before us. The subsection provides that "[w]here a pension plan is wound up ... an employer who is required to pay contributions to the pension fund shall be deemed to hold in trust for the beneficiaries of the pension plan *an amount of money equal to employer contributions accrued to the date of the wind up but not yet due* under the plan or regulations."

135 When a pension plan is wound up there will be an interrupted monthly payment period, which is sometimes referred to as the stub period. During this stub period regular and special liabilities will have accrued but not yet become due. Section 58(1) provides that money that an employer is required to pay "accrues on a daily basis". Because the amounts referred to in s. 57(4) are not yet due, they are not covered by the s. 57(3) deemed trust, which applies only to payments that are *due*. The two provisions, then, operate in tandem to create a trust over an employer's unfulfilled obligations, which are "due and not paid" as well as those which have "accrued to the date of the wind up but [are] not yet due".

(4) The Interpretative Approach

136 The issue we confront is one of statutory interpretation and the well-settled approach is that "the words of an Act are to be read in their entire context and in their grammatical and ordinary sense harmoniously with the scheme of the Act, the object of the Act, and the intention of Parliament": E. A. Driedger, *Construction of Statutes* (2nd ed. 1983), at p. 87; *Bell ExpressVu Ltd. Partnership v. Rex*, 2002 SCC 42, [2002] 2 S.C.R. 559 (S.C.C.), at para. 26. Taking this approach it is clear to me that the sponsor's obligation to pay a wind-up deficiency is not covered by the statutory deemed trust provided for in s. 57(4) of the *PBA*. In my view, the deficiency neither "accrued", nor did it arise within the period referred to by the words "to the date of the wind up".

(a) Grammatical and Ordinary Sense of the Words "Accrued" and "to the Date of the Wind Up"

137 The Court of Appeal failed to take sufficient account of the ordinary and grammatical meaning of the text of the provisions. It held that "the deemed trust in s. 57(4) applies *to all employer contributions that are required to be made pursuant to s. 75*": para. 101 (emphasis added). However, the plain words of the section show that this conclusion is erroneous. Section 75(1)(a) refers to liability for employer contributions that "*are due* ... and that have not been paid". These amounts are thus *not* included in the s. 57(4) deemed trust, because it addresses only amounts that have "accrued to the date of the wind up *but [are] not yet due*". Amounts "due" are covered by the s. 57(3) deemed trust and not, as the Court of Appeal concluded by the deemed trust created by s. 57(4). The Court of Appeal therefore erred in finding, in effect, that amounts which "are due" could be included in a deemed trust covering amounts "not yet due".

138 In my view, the most plausible grammatical and ordinary sense of the phrase "accrued to the date of the wind up" in s. 57(4) is that it refers to the sums that are ascertained immediately before the effective wind-up date of the plan.

139 In the context of s. 57(4), the grammatical and ordinary sense of the term "accrued" is that the amount of the obligation is "fully constituted" and "ascertained" although it may not yet be payable. The amount of the wind-up deficiency is not fully constituted or ascertained (or even ascertainable) before or even on the date fixed for wind up and therefore cannot fall under s. 57(4).

140 Of course, the meaning of the word "accrued" may vary with context. In general, when the term "accrued" is used in relation to legal rights, its common meaning is that the right has become fully constituted even though the monetary implications of its enforcement are not yet known or knowable. Thus, we speak of the "accrual" of a cause of action in

tort when all of the elements of the cause of action come into existence, even though the extent of the damage may well not be known or knowable at that time: see, e.g., *Ryan v. Moore*, 2005 SCC 38, [2005] 2 S.C.R. 53 (S.C.C.). However, when the term is used in relation to a sum of money, it will generally refer to an amount that is at the present time either quantified or exactly quantifiable but which may or may not be due.

141 In some contexts, a liability is said to accrue when it becomes due. An accrued liability is said to be "properly chargeable" or "owing on a given day" or "completely constituted": see, e.g., *Black's Law Dictionary* (9th ed. 2009), at p. 997, "accrued liability"; D.A. Dukelow, *The Dictionary of Canadian Law* (4th ed. 2011), at p. 13, "accrued liability"; *Ontario Hydro-Electric Power Commission v. Albright* (1922), 64 S.C.R. 306 (S.C.C.).

142 In other contexts, an amount which has accrued may not yet be due. For example, we speak of "accrued interest" meaning a precise, quantified amount of interest that has been earned but may not yet be payable. The term "accrual" is used in the same way in "accrual accounting". In accrual method accounting, "transactions that give rise to revenue or costs are recognized in the accounts when they are earned and incurred respectively": B. J. Arnold, *Timing and Income Taxation: The Principles of Income Measurement for Tax Purposes* (1983), at p. 44. Revenue is earned when the recipient "substantially completes performance of everything he or she is required to do as long as the amount due is ascertainable and there is no uncertainty about its collection": P. W. Hogg, J. E. Magee and J. Li, *Principles of Canadian Income Tax Law* (7th ed., 2010), at s. 6.5(b); see also Canadian Institute of Chartered Accountants, *CICA Handbook — Accounting*, Part II, s. 1000, at paras. 41-44. In this context, the amount must be ascertained at the time of accrual.

143 The *Hydro-Electric Power Commission* case offers a helpful definition of the word "accrued" in this sense. On a sale of shares, the vendor undertook to provide on completion "a sum estimated by him to be equal to sinking fund payments [on the bonds and debentures] *which shall have accrued but shall not be due* at the time for completion": p. 344 (emphasis added). The bonds and debentures required the company to pay on July 1 of each year a fixed sum for each electrical horsepower sold and paid for during the preceding calendar year. A dispute arose as to what amounts were payable in this respect on completion. Duff J. held that in this context accrued meant "completely constituted", referring to this as a "well recognized usage": p. 312. He went on:

> Where ... a lump sum is made payable on a specified date and where, having regard to the purposes of the payment or to the terms of the instrument, this sum must be considered to be made up of an accumulation of sums in respect of which the right to receive payment is completely constituted before the date fixed for payment, then it is quite within the settled usage of lawyers to describe each of such accumulated parts as a sum accrued or accrued due before the date of payment: p. 316.

Thus, at every point at which a liability to pay a fixed sum arose under the terms of the contract, that liability accrued. It was fully constituted even though not yet due because the obligation to make the payment was in the future. In reaching this conclusion, Duff J. noted that the bonds and debentures used the word "accrued" in contrast to "due" and that this strengthened the interpretation of "accrued" as an obligation fully constituted but not yet payable. Similarly in s. 57(4), the word "accrued" is used in contrast to the word "due".

144 Given my understanding of the ordinary meaning of the word "accrued", I must respectfully disagree with my colleague, Justice Deschamps' position that the wind-up deficiency can be said to have "accrued" to the date of wind up. In her view, "[s]ince the employees cease to accumulate entitlements when the plan is wound up, the entitlements that are used to calculate the contributions have all been accumulated before the wind-up date" (para. 34) and "no new liabilities accrue at the time of or after the wind up" (para. 36). My colleague maintains that "[t]he fact that the precise amount of the contribution is not determined as of the time of the wind up does not make it a contingent contribution that cannot have accrued for accounting purposes" (para. 37 referring to *Canadian Pacific Ltd. v. Ontario (Minister of Revenue)* (1998), 41 O.R. (3d) 606 (Ont. C.A.)).

145 I cannot agree that no new liability accrues on or after the wind up. As discussed in more detail earlier, the wind-up deficiency in s. 75(1)(b) is made up of the difference between the plan's assets and liabilities calculated as of the date

of wind up. On wind up, the *PBA* accords statutory entitlements and protections to employees that would not otherwise be available: Kaplan, at p. 532. Wind up therefore gives rise to new liabilities. In particular, on wind up, and only on wind up, plan beneficiaries are entitled, under s. 74, to make elections regarding the payment of their benefits. The plan's liabilities cannot be determined until those elections are made. Contrary to what my colleague Justice Deschamps suggests, the extent of the wind-up deficiency depends on employee rights that arise only upon wind up and with respect to which employees make elections only after wind up.

146 Moreover, the wind-up deficiency will vary after wind up because the amount of money necessary to provide for the payment of the plan sponsor's liabilities will vary with the market. Section 31 of the *PBA* Regulations allows s. 75 payments to be spaced out over the course of five years. As we have seen, the amount of the wind-up deficiency will fluctuate over this period (I set out earlier how this amount in fact fluctuated markedly in the case of the salaried plan in issue here). Thus, while estimates are periodically made and reported after the wind up to determine how much the employer needs to pay, the precise amount of the wind-up deficiency is not ascertained or ascertainable on the date of the wind up.

147 I turn next to the ordinary and grammatical sense of the words "to the date of the wind up" in s. 57(4). In my view, these words indicate that only those contributions that accrue before the date of wind up, and not those amounts the liability for which arises only on the day of wind up — that is, the wind-up deficiency — are included.

148 Where the legislature intends to include the date of wind up, it has used suitable language to effect that purpose. For example, the English version of a provision amending the *PBA* in 2010 (c. 24, s. 21(2)), s. 68(2)(c), indicates which trade unions are entitled to notice of the wind up:

> (2) If the employer or the administrator, as the case may be, intends to wind up the pension plan, the administrator shall give written notice of the intended wind up to,
>
> . . . . .
>
> (c) each trade union that represents members of the pension plan or that, <u>on the date of the wind up</u>, represented the members, former members or retired members of the pension plan;

In contrast to the phrase "to the date of wind up", "on the date of wind up" clearly includes the date of wind up. (The French version does not indicate a different intention.) Similarly, s. 70(6), which formed part of the *PBA* until 2012 (rep. S.O. 2010, c. 9, s. 52(5)), read as follows:

> (6) On the partial wind up of a pension plan, members, former members and other persons entitled to benefits under the pension plan shall have rights and benefits that are not less than the rights and benefits they would have on a full wind up of the pension plan <u>on the effective date of the partial wind up</u>.

The words "on the effective date of the partial wind up" indicate that the members are entitled to those benefits from the date of the partial wind up, in the sense that members can claim their benefits beginning on the date of the wind up itself. This is how the legislature expresses itself when it wants to speak of a period of time including a specific date. By comparison, "to the date of the wind up" is devoid of language that would include the actual date of wind up. This conclusion is further supported by the structure of the *PBA* and its legislative history and evolution, to which I will turn shortly.

149 To sum up with respect to the ordinary and grammatical meaning of the phrase "accrued to the date of the wind up", the most plausible ordinary and grammatical meaning is that such amounts are fully constituted and precisely ascertained immediately before the date fixed as the date of wind up. Thus, according to the ordinary and grammatical meaning of the words, the wind-up deficiency obligation set out in s. 75(1)(b) has not "*accrued* to the date of the wind up" as required by s. 57(4). Moreover, the liability for the wind-up deficiency arises where a pension plan is wound up (s. 75(1)(b)) and so it cannot be a liability that "accrued *to the date of the wind up*" (s. 57(4)).

(b) The Scheme of the Act

150 As discussed earlier, s. 57 establishes deemed trusts over funds which must be contributed to a pension plan, including the one in s. 57(4), which is at issue here. It is helpful to consider these deemed trusts in the context of the obligations to pay funds which give rise to them. Specifically, the relationship between the deemed trust provisions in s. 57(3) and (4), on one hand, and s. 75(1), which sets out liabilities on wind up on the other. According to my colleague Justice Deschamps, s. 75(1) "elegantly parallels the wind-up deemed trust provision" (para. 42) such that the deemed trusts must include the wind-up deficiency. I disagree. In my view, the deemed trusts parallel only s. 75(1)(a), which does not relate to the wind-up deficiency. The correspondence between the deemed trusts and s. 75(1)(a), and the absence of any such correspondence with s. 75(1)(b), makes it clear that the wind-up deficiency is not covered by the deemed trust provisions.

151 I would recall here the difference between the deemed trusts created by s. 57(3) and (4). While a plan is ongoing, there may be payments which the employer is required to, but has failed to make. The s. 57(3) trust applies to these payments because they are "*due and not paid*". When a plan is wound up, however, there will be payments that are outstanding in the sense that they are fully constituted, but not yet due. This occurs with respect to the so-called stub period referred to earlier. During this stub period, regular and special liabilities will accrue on a daily basis, as provided for in s. 58(1), but may not be due at the time of wind up. While s. 57(3) cannot apply to these payments because they are not yet due, the deemed trust under s. 57(4) applies to these payments because liability for them has "accrued to the date of the wind up" and they are "*not yet due*".

152 The important point is how these two deemed trust provisions relate to the wind-up liabilities as described in ss. 75(1)(a) and 75(1)(b). The two paragraphs refer to sums of money that are different in kind: while s. 75(1)(a) refers to liabilities that accrue before wind up and that are created elsewhere in the Act, s. 75(1)(b) creates a completely new liability that comes into existence only once the plan is wound up. There is no dispute, as I understand it, that these two paragraphs refer to different liabilities and that it is the liability described in s. 75(1)(b) that is the wind-up deficiency in issue here. The parties do not dispute that s. 75(1)(a) does *not* include wind-up deficiency payments.

153 It is striking how closely the text of s. 75(1)(a) — which does not relate to the wind-up deficiency — tracks the language of the deemed trust provisions in s. 57(3) and (4). As noted, s. 57(3) deals with "employer contributions due and not paid", while s. 57(4) deals with "employer contributions accrued to the date of the wind up but not yet due." Section 75(1)(a) includes both of these types of employer contributions. It refers to "payments that ... are due ... and that have not been paid" (i.e. subject to the deemed trust under s. 57(3)) or that have "accrued and that have not been paid" (i.e. subject to the deemed trust under s. 57(4) to the extent that these payments accrued to the date of wind up). This very close tracking of the language between s. 57(3) and (4) on the one hand and s. 75(1)(a) on the other, and the absence of any correspondence between the language of these deemed trust provisions with s. 75(1)(b), suggests that the s. 57(3) and (4) deemed trusts refer to the liability described in s. 75(1)(a) and not to the wind-up deficiency created by s. 75(1)(b). It is difficult to understand why, if the intention had been for s. 57(4) to capture the windup deficiency liability under s. 75(1)(b), the legislature would have so closely tracked the language of s. 75(1)(a) alone in creating the deemed trusts. Thus, in my respectful view, the elegant parallel to which my colleague, Justice Deschamps refers exists only between the deemed trust and s. 75(1)(a), and not between the deemed trust and the wind-up deficiency.

154 I conclude that the scheme of the *PBA* reinforces my conclusion that the ordinary grammatical sense of the words in s. 57(4) does not extend to the wind-up deficiency provided for in s. 75(1)(b).

(c) Legislative History and Evolution

155 Legislative history and evolution may form an important part of the overall context within which a provision should be interpreted. Legislative evolution refers to the various formulations of the provision while legislative history

refers to evidence about the provision's conception, preparation and enactment: see, e.g., *Canada (Attorney General) v. Mowat*, 2011 SCC 53, [2011] 3 S.C.R. 471 (S.C.C.), at para. 43.

156 Both the legislative evolution and history of the *PBA* show that it was never the legislature's intention to include the wind-up deficiency in the deemed trust. The evolution and history of the *PBA* are rather intricate and sometimes difficult to follow so I will review them briefly here before delving into a more detailed analysis.

157 The deemed trust was first introduced into the *PBA* in 1973. At that time, it covered employee contributions held by the employer and employer contributions that were due but not paid. In 1980, the *PBA* was amended so that the deemed trust was expanded to include employer contributions whether they were due or not. Also, new provisions were added allowing for employee elections and requiring additional payments by the employer where a plan was wound up. The 1980 amendments gave rise to confusion on two fronts: first, it was unclear whether the payments that were required on wind up were subject to the deemed trust; second, it was unclear whether a lien over some employer contributions covered the same amount as the deemed trust. In 1983, both these points were clarified. The sections were reworded and rearranged to make it clear that the wind-up deficiency was distinct from the amounts covered by the deemed trust, and that the lien and the deemed trust covered the same amount. A statement by the responsible Minister in 1982 confirms that *the deemed trusts were never intended to cover the wind-up deficiency*.

158 My colleague, Justice Deschamps maintains that this history suggests an evolution in the intention of the legislature from protecting "only the service contributions that were due ... to all amounts due and accrued upon wind up" (para. 42). I respectfully disagree. In my view, the history and evolution of the *PBA* leading up to and including 1983 show that the legislature never intended to include the windup deficiency in the deemed trust. Moreover, legislative evolution after 1983 confirms that this intention did not change.

(i) The Pension Benefits Amendment Act, 1973, S.O. 1973, c. 113

159 So far as I can determine, statutory deemed trusts were first introduced into the *PBA* by *The Pension Benefits Amendment Act*, *1973*, S.O. 1973, c. 113, s. 6. Those amendments created deemed trusts over two amounts: employee pension contributions received by employers (s. 23*a*(1), similar to the deemed trust in the current s. 57(1)) and employer contributions that had fallen due under the plan (s. 23*a*(3), similar to the current s. 57(3) deemed trust for employer contributions "due and not paid"). The full text of these provisions and those referred to below, up to the current version of the 1990 Act, are found in the Appendix.

(ii) The Pension Benefits Amendment Act, 1980, S.O. 1980, c. 80

160 Ontario undertook significant pension reform leading to *The Pension Benefits Amendment Act, 1980*, S.O. 1980, c. 80; see Kaplan at pp. 54-56. I will concentrate on the deemed trust provisions and how they related to the liabilities on wind up and, for ease of reference, I will refer to the sections as they were renumbered in the 1980 consolidation: R.S.O. 1980, c. 373. The 1980 legislation expanded the deemed trust relating to employer contributions. Although far from clear, the new provisions appear to have created a deemed trust and lien over the employer contributions whether otherwise payable or not and calculated as if the plan had been wound up on the relevant date.

161 It was unclear after the reforms of 1980 whether the deemed trust applied to all employer contributions that arose on wind up. According to s. 23(4), on any given date, the trust extended to an amount to be determined "as if the plan had been wound up on that date". However, the provisions of the 1980 version of the Act did not explicitly state what such a calculation would include. Under s. 21(2) of the 1980 statute, the employer was obligated to pay on wind up "all amounts that would otherwise have been required to be paid to meet the tests for solvency ..., up to the date of such termination or winding up". Under s. 32, however, the employer had to make a payment on wind up that was to be "[i]n addition" to that due under s. 21(2). Whether the legislature intended that the trust should cover this latter payment was left unclear.

162 It was also unclear whether the lien applied to a different amount than was subject to the deemed trust. According to s. 23(3), "the members have a lien upon the assets of the employer in such amount that in the ordinary course of

business would be entered into the books of account whether so entered or not". This comes in the middle of two portions of the provision which explicitly refer to the deemed trust, but it is not clear whether the legislature intended to refer to the same amount throughout the provision.

(iii) The Pension Benefits Amendment Act, 1983, S.O. 1983, c. 2

163 The 1983 amendments substantially clarified the scope of the deemed trust and lien for employer contributions. They make clear that neither the deemed trust nor the lien applied to the wind-up deficiency; the responsible Minister confirmed that this was the intention of the amendments.

164 The new provision was amended by s. 3 of the 1983 amendments and is found in s. 23(4) which provided:

> (4) An employer who is required by a pension plan to contribute to the pension plan shall be deemed to hold in trust for the members of the pension plan an amount of money equal to the total of,
>
> (a) all moneys that the employer is required to pay into the pension plan to meet,
>
> (i) <u>the current service cost</u>, and
>
> (ii) <u>the special payments</u> prescribed by the regulations,
>
> that are due under the pension plan or the regulations and have not been paid into the pension plan; and
>
> (b) <u>where the pension plan is terminated or wound up, any other money that the employer is liable to pay under clause 21 (2) (a)</u>.

Section 21(2)(a) provides that on wind up, the employers must pay an amount equal to *the current service cost and the special payments* that "have accrued to and including the date of the termination winding up but, under the terms of the pension plan or the regulations, are not due on that date"; the provision adds that these amounts shall be deemed to accrue on a daily basis. These provisions make it clear that the s. 23(4) deemed trust applies only to the special payments and current service costs that have accrued, on a daily basis, up to and including the date of wind up. The deemed trust clearly does not extend to the wind-up deficiency.

165 The provision referring to the additional payments required on wind up also makes clear that those payments are not within the scope of the deemed trust. These additional liabilities were described by s. 32, a provision very similar to s. 75(1)(b). These amounts are first, the amount guaranteed by the Guarantee Fund and, second, the value of pension benefits vested under the plan that exceed the value of the assets of the plan. Section 32(2) specifies that these amounts *are* "*in addition* to the amounts that the employer is liable to pay under subsection 21(2)" (which are the payments comparable to the current s. 75(1)(a) payments) and that *only the latter* fall within the deemed trust. The inevitable conclusion is that, in 1983, the wind-up deficiency was not included in the scope of the deemed trust.

166 The 1983 amendments also clarified the scope of the lien. They indicated that the scope of the lien was identical to the scope of the deemed trust. Section 23(5) specified that the lien extended only to the amounts that were deemed to be held in trust under s. 23(4) (i.e. the *current service costs and special payments that had accrued to and including the date of the wind up but are not yet due)*.

167 This makes two things clear: that the lien covers the same amounts as the deemed trust, and that neither covers the wind-up deficiency.

168 A brief, but significant piece of legislative history seems to me to dispel any possible doubt. In speaking at first reading of the 1983 amendments, the Minister responsible, the Honourable Robert Elgie said this:

The first group of today's amendments makes up the housekeeping changes needed for us to do what we set out to do in late 1980; that is, to guarantee pension benefits following the windup of a defined pension benefit plan. These amendments will clarify the ways in which we can attain that goal.

In Bill 214 [i.e. the 1980 amendments] the employees were given a lien on the employer's assets for employee contributions to a pension plan collected by the employer, as well as accrued employer contributions....

Unfortunately, this protection has resulted in different legal interpretations on the extent of the lien. An argument has been advanced that the amount of the lien includes an employer's potential future liability on the windup of a pension plan. This was never intended and is not necessary to provide the required protection. The amendment to section 23 clarified the intent of Bill 214. [Emphasis added.]

(*Legislature of Ontario Debates: Official Report (Hansard)*, No. 99, 2nd Sess., 32nd Parl., July 7, 1982, p. 3568)

The 1983 amendments made the scope of the lien correspond precisely to the scope of the deemed trust over the employer's accrued contributions. It is thus clear from this statement that it was never the legislative intention that either should apply to "an employer's potential future liability" on wind up (i.e. the wind-up deficiency). In 1983, there is therefore, in my view, virtually irrefutable evidence of legislative intent to do exactly the opposite of what the Court of Appeal held in this case had been done.

169 Subsequent legislative evolution shows no change in this legislative intent. In fact, subsequent amendments demonstrate a clear legislative intent to exclude from the deemed trust employer liabilities that arise only upon wind up of the plan.

(iv) Pension Benefits Act, 1987, S.O. 1987, c. 35

170 Amendments to the *PBA* in 1987 resulted in it being substantially in its current form. With those amendments, the extent of the deemed trusts was further clarified. The provision in the 1983 version of the Act combined within a single subsection a deemed trust for employer contributions that were due and not paid (s. 23(4)(a)) and employer contributions that had accrued to and including the date of wind up but which were not yet due (s. 23(4)(b), referring to s. 21(2)(a)). In the 1987 amendments, these two trusts were each given their own subsection and their scope was further clarified. Moreover, after the 1987 revision, one no longer had to refer to a separate provision (formerly s. 21(2)(a)) to determine the scope of the trust covering payments that were accrued but not yet due. Thus, while the substance of the provisions did not change in 1987, their form was simplified.

171 The new s. 58(3) (which is exactly the same as the current s. 57(3)) replaced the former s. 23(4)(a). This created a trust for employer contributions due and not paid. Section 58(4) (which is exactly the same as s. 57(4) stood at the time) replaced the former s. 23(4)(b) and part of s. 21(2)(a) and created a trust that arises on wind up and covers "employer contributions accrued *to the date of the wind up* but not yet due".

172 The 1987 amendment also shows that the legislature adverted to the difference between "to the date of the wind up" and "to and including" the date of wind up and chose the former. This is reflected in a small but significant change in the wording of the relevant provisions. The former provision, s. 23(4)(b), by referring to s. 21(2)(a) captured current service costs and special payments that "have *accrued to and including* the date of the termination or winding up." The new version in s. 58(4) deletes the words "and including", putting the section in its present form. This deletion, to my way of thinking, reinforces the legislative intent to *exclude* from the deemed trust liabilities that arise only *on* the date of wind up. Respectfully, the legislative record does not support Deschamps J.'s view that there was a legislative evolution towards a more expanded deemed trust. Quite the opposite.

173 To sum up, I draw the following conclusions from this review of the legislative evolution and history. The legislation differentiates between two types of employer liability relevant to this case. The first is the contributions required to cover

current service costs and any other payments that are either due or have accrued on a daily basis up to the relevant time. These are the payments referred to in the current s. 75(1)(a), that is, payments due or accrued but not paid. The second relates to additional contributions required when a plan is wound up which I have referred to as the wind-up deficiency. These payments are addressed in s. 75(1)(b). The legislative history and evolution show that the deemed trusts under s. 57(3) and (4) were intended to apply only to the former amounts and that it was never the intention that there should be a deemed trust or a lien with respect to an employer's potential future liabilities that arise once the plan is wound up.

(d) The Purpose of the Legislation

174 Excluding the wind-up deficiency from the deemed trust is consistent with the broader purposes of the legislation. Pension legislation aims at important protective purposes. These protective purposes, however, are not pursued at all costs and are clearly intended to be balanced with other important interests within the context of a carefully calibrated scheme: *Monsanto Canada Inc. v. Ontario (Superintendent of Financial Services)*, 2004 SCC 54, [2004] 3 S.C.R. 152 (S.C.C.), at paras. 13-14.

175 In this instance, the legislature has created trusts over contributions that were due or accrued to the date of the wind up in order to protect, to some degree, the rights of pension plan beneficiaries and employees from the claims of the employer's other creditors. However, there is also good reason to think that the legislature had in mind other competing objectives in not extending the deemed trust to the wind-up deficiency.

176 First, if there were to be a deemed trust over all employer liabilities that arise when a plan is wound up, much simpler and clearer words could readily be found to achieve that objective.

177 Second, extending the deemed trust protections to the wind-up deficiency might well be viewed as counter-productive in the greater scheme of things. A deemed trust of that nature might give rise to considerable uncertainty on the part of other creditors and potential lenders. This uncertainty might not only complicate creditors' rights, but it might also affect the availability of funds from lenders. The wind-up liability is potentially large and, while the business is ongoing, the extent of the liability is unknown and unknowable for up to five years. Its amount may, as the facts of this case disclose, fluctuate dramatically during this time. A liability of this nature could make it very difficult to assess the creditworthiness of a borrower and make an appropriate apportionment of payment among creditors extremely difficult.

178 While I agree that the protection of pension plans is an important objective, it is not for this Court to decide the extent to which that objective will be pursued and at what cost to other interests. In her conclusion, Justice Deschamps notes that although the protection of pension plans is a worthy objective, courts should not use the law of equity to re-arrange the priorities that Parliament has established under the *CCAA*. This is a matter of policy where courts must defer to legislatures (reasons of Justice Deschamps, at para. 82). In my view, my colleague's comments on this point are equally applicable to the policy decisions reflected in the text of the *PBA*. The decision as to the level of protection that should be provided to pension beneficiaries is one to be left to the Ontario legislature. Faced with the language in the *PBA*, I would be slow to infer that the broader protective purpose, with all its potential disadvantages, was intended. In short, the interpretation I would adopt is consistent with a balanced approach to protection of benefits which the legislature intended.

179 For these reasons, I am of the respectful view that the Court of Appeal erred in finding that the s. 57(4) deemed trust applied to the wind-up deficiency.

B. Second Issue: Did the Court of Appeal Err in Finding That Indalex Breached the Fiduciary Duties it Owed to the Pension Beneficiaries as the Plans' Administrator and in Imposing a Constructive Trust as a Remedy?

(1) Introduction

180 The Court of Appeal found that during the *CCAA* proceedings Indalex breached its fiduciary obligations as administrator of the pension plans: para. 116. As a remedy, it imposed a remedial constructive trust over the reserve fund,

effectively giving the plan beneficiaries recovery of 100 cents on the dollar in priority to all other creditors, including creditors entitled to the super priority ordered by the *CCAA* court.

181 The breaches identified by the Court of Appeal fall into three categories. First, Indalex breached the prohibition against a fiduciary being in a position of conflict of interest because its interests in dealing with its insolvency conflicted with its duties as plan administrator to act in the best interests of the plans' members and beneficiaries: para. 142. According to the Court of Appeal, the simple fact that Indalex found itself in this position of conflict of interest was, of itself, a breach of its fiduciary duty as plan administrator. Second, Indalex breached its fiduciary duty by applying, without notice to the plans' beneficiaries, for *CCAA* protection: para. 139. Third, Indalex breached its fiduciary duty by seeking and/or obtaining various relief in the *CCAA* proceedings including the "super priority" in favour of the DIP lenders, approval of the sale of the business knowing that no payment would be made to the underfunded plans over the statutory deemed trusts and seeking to be put into bankruptcy with the intention of defeating the deemed trust claims: para. 139. As a remedy for these breaches of fiduciary duty the court imposed a constructive trust.

182 In my view, the Court of Appeal took much too expansive a view of the fiduciary duties owed by Indalex as plan administrator and found breaches where there were none. As I see it, the only breach of fiduciary duty committed by Indalex occurred when, upon insolvency, Indalex's corporate interests were in obvious conflict with its fiduciary duty as plan administrator to ensure that all contributions were made to the plans when due. The breach was not in failing to avoid this conflict — the conflict itself was unavoidable. Its breach was in failing to address the conflict to ensure that the plan beneficiaries had the opportunity to have representation in the *CCAA* proceedings as if there were independent plan administrators. I also conclude that a remedial constructive trust is not available as a remedy for this breach.

183 This part of the appeals requires us to answer two questions which I will address in turn:

(i) What fiduciary duties did Indalex have in its role as plan administrator and did it breach them?

(ii) If so, was imposition of a constructive trust an appropriate remedy?

(2) What Fiduciary Duties did Indalex Have in its Role as Plan Administrator and Did it Breach Those Duties?

(a) Legal Principles

184 The appellants do not dispute that Indalex, in its role of administrator of the plans, had fiduciary duties to the members of the plan and that when it is acting in that role it can only act in the interests of the plans' beneficiaries. It is not necessary for present purposes to decide whether a pension plan administrator is a *per se* or *ad hoc* fiduciary, although it must surely be rare that a pension plan administrator would not have fiduciary duties in carrying out that role: *Burke v. Hudson's Bay Co.*, 2010 SCC 34, [2010] 2 S.C.R. 273 (S.C.C.), at para. 41, aff'g 2008 ONCA 394, 67 C.C.P.B. 1 (Ont. C.A.), at para. 55.

185 However, the conclusion that Indalex as plan administrator had fiduciary duties to the plan beneficiaries is the beginning, not the end of the inquiry. This is because fiduciary duties do not exist at large, but arise from and relate to the specific legal interests at stake: *Elder Advocates of Alberta Society v. Alberta*, 2011 SCC 24, [2011] 2 S.C.R. 261 (S.C.C.), at para. 31. As La Forest J. put it in *International Corona Resources Ltd. v. LAC Minerals Ltd.*, [1989] 2 S.C.R. 574 (S.C.C.):

> The obligation imposed [on a fiduciary] <u>may vary in its specific substance depending on the relationship</u> ... [N]ot every legal claim arising out of a relationship with fiduciary incidents will give rise to a claim for breach of fiduciary duty.... <u>It is only in relation to breaches of the specific obligations imposed because the relationship is one characterized as fiduciary that a claim for breach of fiduciary duty can be founded.</u>
>
> [Emphasis added; pp. 646-47.]

186 The nature and scope of the fiduciary duty must, therefore, be assessed in the legal framework governing the relationship out of which the fiduciary duty arises: see, e.g., *Sharbern Holding Inc. v. Vancouver Airport Centre Ltd.*, 2011 SCC 23, [2011] 2 S.C.R. 175 (S.C.C.), at para. 141; *Perez v. Galambos*, 2009 SCC 48, [2009] 3 S.C.R. 247 (S.C.C.), at paras. 36-37; *B. (K.L.) v. British Columbia*, 2003 SCC 51, [2003] 2 S.C.R. 403 (S.C.C.), at para. 41. So, for example, as a general rule, a fiduciary has a duty of loyalty including the duty to avoid conflicts of interest: see, e.g., *3464920 Canada Inc. v. Strother*, 2007 SCC 24, [2007] 2 S.C.R. 177 (S.C.C.), at para. 35; *Lac Minerals*, at pp. 646-47. However, this general rule may have to be modified in light of the legal framework within which a particular fiduciary duty must be exercised. In my respectful view, this is such a case.

(b) The Legal Framework of Indalex's Dual Role as a Plan Administrator and Employer

187 In order to define the nature and scope of Indalex's role and fiduciary obligations as a plan administrator, we must examine the legal framework within which the administrator functions. This framework is established primarily by the plan documents and the relevant provisions of the *PBA*. It is to these sources, first and foremost, that we look in order to shape the specific fiduciary duties owed in this context.

188 Turning first to the plan documents, I take the salaried plan as an example. Under it, the company is appointed the plan administrator: art. 13.01. The term "Company" is defined to mean Indalex Limited and any reference in the plan to actions taken or discretion to be exercised by the Company means Indalex acting through the board of directors or any person authorized by the board for the purposes of the plan: art. 2.09. Article 13.01 provides that the "Management Committee of the Board of Directors of the Company will appoint a Pension and Benefits Committee to act on behalf of the Company in its capacity as administrator of the Plan. The Pension and Benefits Committee will decide conclusively all matters relating to the operation, interpretation and application of the Plan." Thus, the Pension and Benefits Committee is to act on behalf of the company and by virtue of art. 2.09 its acts are considered those of the company. Article 13.02 sets out the duties of the Pension and Benefits Committee which include the "performance of all administrative functions not performed by the Funding Agent, the Actuary or any group annuity contract issuer": art. 13.02(1).

189 The plan administrator also has statutory powers and duties by virtue of the *PBA*. Section 22 lists the general duties of plan administrators, three of which are particularly relevant to these appeals:

> **22.** (1) [Care, diligence and skill] The administrator of a pension plan shall exercise the care, diligence and skill in the administration and investment of the pension fund that a person of ordinary prudence would exercise in dealing with the property of another person.
>
> (2) [Special knowledge and skill] The administrator of a pension plan shall use in the administration of the pension plan and in the administration and investment of the pension fund all relevant knowledge and skill that the administrator possesses or, by reason of the administrator's profession, business or calling, ought to possess.
>
> . . . . .
>
> (4) [Conflict of interest] An administrator or, if the administrator is a pension committee or a board of trustees, a member of the committee or board that is the administrator of a pension plan shall not knowingly permit the administrator's interest to conflict with the administrator's duties and powers in respect of the pension fund.

190 Not surprisingly, the powers and duties conferred on the administrator by the legislation are administrative in nature. For the most part they pertain to the internal management of the pension fund and to the relationship among the pension administrator, the beneficiaries, and the Superintendent of Financial Services ("Superintendent"). The list includes: applying to the Superintendent for registration of the plan and any amendments to it as well as filing annual information returns: ss. 9, 12 and 20 of the *PBA*; providing beneficiaries and eligible potential beneficiaries with information and documents: ss. 10(1)12 and 25; ensuring that the plan is administered in accordance with the *PBA* and its regulations and plan documents: s. 19; notifying beneficiaries of proposed amendments to the plan that would reduce benefits: s. 26; paying commuted value for pensions: s. 42; and filing wind-up reports if the plan is terminated: s. 70.

191 Of special relevance for this case are two additional provisions. Under s. 56, the administrator has a duty to ensure that pension payments are made when due and to notify the Superintendent if they are not and, under s. 59, the administrator has the authority to commence court proceedings when pension payments are not made.

192 The fiduciary duties that employer-administrators owe to plan beneficiaries relate to the statutory and other tasks described above; these are the "specific legal interests" with respect to which the employer-administrator's fiduciary duties attach.

193 Another important aspect of the legal context for Indalex's fiduciary duties as a plan administrator is that it was acting in the dual role of an employer-administrator. This dual role is expressly permitted under s. 8(1)(a) of the *PBA*, but this provision creates a situation where a single entity potentially owes two sets of fiduciary duties (one to the corporation and the other to the plan members).

194 This was the case for Indalex. As an employer-administrator, Indalex acted through its board of directors and so it was that body which owed fiduciary duties to the plan members. The board of directors also owed a fiduciary duty to the company to act in its best interests: *Canada Business Corporations Act*, R.S.C. 1985, c. C-44, s. 122(1)(*a*); *BCE Inc., Re*, 2008 SCC 69, [2008] 3 S.C.R. 560 (S.C.C.), at para. 36. In deciding what is in the best interests of the corporation, a board may look to the interests of shareholders, employees, creditors and others. But where those interests are not aligned or may conflict, it is for the directors, acting lawfully and through the exercise of business judgment, to decide what is in the overall best interests of the corporation. Thus, the board of Indalex, as an employer-administrator, could not always act exclusively in the interests of the plan beneficiaries; it also owed duties to Indalex as a corporation.

(c) Breaches of Fiduciary Duty

195 Against the background of these legal principles, I turn to consider the Court of Appeal's findings in relation to Indalex's breach of its fiduciary duties as administrator of the plans. As noted, they fall into three categories: being in a conflict of interest position; taking steps to reduce pension obligations in the *CCAA* proceedings; and seeking bankruptcy status.

(i) Conflict of Interest

196 The questions here are first what constitutes a conflict of interest or duty between Indalex as business decision-maker and Indalex as plan administrator and what must be done when a conflict arises?

197 The Court of Appeal in effect concluded that a conflict of interest arises whenever Indalex makes business decisions that have "the potential to affect the Plans beneficiaries' rights" (para. 132) and that whenever such a conflict of interest arose, the employer-administrator was immediately in breach of its fiduciary duties to the plan members. Respectfully, this position puts the matter far too broadly. It cannot be the case that a conflict arises simply because the employer, exercising its management powers in the best interests of the corporation, does something that has the potential to affect the plan beneficiaries.

198 This conclusion flows inevitably from the statutory context. The existence of apparent conflicts that are inherent in the two roles being performed by the same party cannot be a breach of fiduciary duty because those conflicts are specifically authorized by the statute which permits one party to play both roles. As noted earlier, the *PBA* specifically permits employers to act as plan administrators (s. 8(1)(a)). Moreover, the broader business interests of the employer corporation and the interests of pension beneficiaries in getting the promised benefits are almost always at least potentially in conflict. Every important business decision has the potential to put at risk the solvency of the corporation and therefore its ability to live up to its pension obligations. The employer, within the limits set out in the plan documents and the legislation generally, has the authority to amend the plan unilaterally and even to terminate it. These steps may well not serve the best interests of plan beneficiaries.

199 Similarly, the simple existence of the sort of conflicts of interest identified by the Court of Appeal — those inherent in the employer's exercise of business judgment — cannot of themselves be a breach of the administrator's fiduciary duty. Once again, that conclusion is inconsistent with the statutory scheme that expressly permits an employer to act as plan administrator.

200 How, then, should we identify conflicts of interest in this context?

201 In *R. v. Neil*, 2002 SCC 70, [2002] 3 S.C.R. 631 (S.C.C.), Binnie J. referred to the *Restatement Third, The Law Governing Lawyers* (2000), at § 121, to explain when a conflict of interest occurs in the context of the lawyer-client relationship: para. 31. In my view, the same general principle, adapted to the circumstances, applies with respect to employer-administrators. Thus, a situation of conflict of interest occurs when there is a substantial risk that the employer-administrator's representation of the plan beneficiaries would be materially and adversely affected by the employer-administrator's duties to the corporation. I would recall here, however, that the employer-administrator's obligation to represent the plan beneficiaries extends only to those tasks and duties that I have described above.

202 In light of the foregoing, I am of the view that the Court of Appeal erred when it found, in effect that a conflict of interest arose whenever Indalex was making decisions that "had the potential to affect the Plans beneficiaries' rights": para. 132. The Court of Appeal expressed both the potential for conflict of interest or duty and the fiduciary duty of the plan administrator much too broadly.

(ii) Steps in the CCAA Proceedings to Reduce Pension Obligations and Notice of Them

203 The Court of Appeal found that Indalex breached its fiduciary duty simply by commencing *CCAA* proceedings knowing that the plans were underfunded and by failing to give the plan beneficiaries notice of the proceedings: para. 139. As I understand the court's reasons, the decision to commence *CCAA* proceedings was solely the responsibility of the corporation and not part of the administration of the pension plan: para. 131. The difficulty which the Court of Appeal saw arose from the potential of the *CCAA* proceedings to result in a reduction of the corporation's pension obligations to the prejudice of the beneficiaries: paras. 131-32.

204 I respectfully disagree. Like Justice Deschamps, I find that seeking an initial order protecting the corporation from actions by its creditors did not, on its own, give rise to any conflict of interest or duty on the part of Indalex (reasons of Justice Deschamps, at para. 72).

205 First, it is important to remember that the purpose of *CCAA* proceedings is not to disadvantage creditors but rather to try to provide a constructive solution for all stakeholders when a company has become insolvent. As my colleague, Deschamps J. observed in *Century Services*, at para. 15:

> ... the purpose of the *CCAA* ... is to permit the debtor to continue to carry on business and, where possible, avoid the social and economic costs of liquidating its assets.

In the same decision, at para. 59, Deschamps J. also quoted with approval the following passage from the reasons of Doherty J.A. in *Nova Metal Products Inc. v. Comiskey (Trustee of)* (1990), 41 O.A.C. 282 (Ont. C.A.), at para. 57 (dissenting):

> The legislation is remedial in the purest sense in that it provides a means whereby the devastating social and economic effects of bankruptcy or creditor initiated termination of ongoing business operations can be avoided while a court-supervised attempt to reorganize the financial affairs of the debtor company is made.

For this reason, I would be very reluctant to find that, simply by virtue of embarking on *CCAA* proceedings, an employer-administrator breaches its duties to plan members.

206 Second, the facts of this case do not support the contention that the interests of the plan beneficiaries and the employer were in conflict with respect to the decision to seek *CCAA* protection. It cannot seriously be suggested that some other course would have protected more fully the rights of the plan beneficiaries. The Court of Appeal did not suggest an alternative to seeking *CCAA* protection from creditors, nor did any of the parties. Indalex was in serious financial difficulty and its options were limited: either make a proposal to its creditors (under the *CCAA* or under the *BIA*), or go bankrupt. Moreover, the plan administrator's duty and authority do not extend to ensuring the solvency of the corporation and an independent administrator could not reasonably expect to be consulted about the plan sponsor's decision to seek *CCAA* protection. Finally, the application for *CCAA* proceedings did not reduce pension obligations other than to temporarily relieve the corporation of making special payments and it was the only step with any prospect of the pension funds obtaining from the insolvent corporation the money that would become due. There was thus no conflict of duty or interest between the administrator and the employer when protective action was taken for the purpose of preserving the *status quo* for the benefit of all stakeholders.

207 The Court of Appeal also found that it was a breach of fiduciary duty not to give the plan beneficiaries notice of the initial application for *CCAA* protection. Again, here, I must join Deschamps J. in disagreeing with the Court of Appeal's conclusion. Section 11(1) of the *CCAA* as it stood at the time of the proceedings, provided that parties could commence *CCAA* proceedings without giving notice to interested persons:

> **11.** (1) Notwithstanding anything in the *Bankruptcy and Insolvency Act* or the *Winding-up Act*, where an application is made under this Act in respect of a company, the court, on the application of any person interested in the matter, may, subject to this Act, on notice to any other person or without notice as it may see fit, make an order under this section.

208 This provision was renumbered but not substantially changed when the Act was amended in September of 2009 (S.C. 2005, c. 47, s. 128, in force Sept. 18, 2009, SI/2009-68). Although it is not appropriate in every case, *CCAA* courts have discretion to make initial orders on an *ex parte* basis. This may be an appropriate — even necessary — step in order to prevent "creditors from moving to realize on their claims, essentially a 'stampede to the assets' once creditors learn of the debtor's financial distress": J. P. Sarra, *Rescue! The Companies' Creditors Arrangement Act* (2007), at p. 55 ("*Rescue!*"); see also *Algoma Steel Inc., Re* (2001), 25 C.B.R. (4th) 194 (Ont. C.A.), at para. 7. The respondents did not challenge Morawetz J.'s decision to exercise his discretion to make an *ex parte* order in this case.

209 This is not to say, however, that *ex parte* initial orders will always be required or acceptable. Without attempting to be exhaustive or to express any final view on these issues, I simply note that there have been at least three ways in which courts have mitigated the possible negative effect on creditors of making orders without notice to potentially affected parties. First, courts have been reluctant to grant *ex parte* orders where the situation of the debtor company is not urgent. In *Rescue!*, Janis Sarra explains that courts are increasingly expecting applicants to have given notice before applying for a stay under the *CCAA*: p. 55. An example is *Marine Drive Properties Ltd., Re*, 2009 BCSC 145, 52 C.B.R. (5th) 47 (B.C. S.C.), a case in which Butler J. held that "[i]nitial applications in *CCAA* proceedings should not be brought without notice merely because it is an application under that Act. The material before the court must be sufficient to indicate an emergent situation": para. 27. Second, courts have included "come-back" clauses in their initial orders so that parties could return to court at a later date to seek to set aside some or all of the order: *Rescue!*, at p. 55. Note that such a clause was included in the initial order by Morawetz J.: para. 46. Finally, courts have limited their initial orders to the issues that need to be resolved immediately and have left other issues to be resolved after all interested parties have been given notice. Thus, in *Timminco Ltd., Re*, 2012 ONSC 506, 85 C.B.R. (5th) 169 (Ont. S.C.J. [Commercial List]), Morawetz J. limited the initial *CCAA* order so that priorities were only granted over the party that had been given notice. The discussion of suspending special payments or granting creditors priority over pension beneficiaries was left to a later date, after the parties that would be affected had been given notice. A similar approach was taken in the case of *AbitibiBowater Inc., Re*, 2009 QCCS 6459 (C.S. Que.). In his initial *CCAA* order, Gascon J. put off the decision regarding the suspension of past service contributions or special payments to the pension plans in question until the parties likely to be affected could be advised of the applicant's request: para. 7.

210 Failure to give notice of the initial *CCAA* proceedings was not a breach of fiduciary duty in this case. Indalex's decision to act as an employer-administrator cannot give the plan beneficiaries any greater benefit than they would have if their plan was managed by a third party administrator. Had there been a third party administrator in this case, Indalex would not have been under an obligation to tell the administrator that it was planning to enter *CCAA* proceedings. The respondents are asking this Court to give the advantage of Indalex's knowledge as employer to Indalex as the plan administrator in circumstances where the employer would have been unlikely to disclose the information itself. I am not prepared to blur the line between employers and administrators in this way.

211 I conclude that Indalex did not breach its fiduciary duty by commencing *CCAA* proceedings or by not giving notice to the plan beneficiaries of its intention to seek the initial *CCAA* order.

212 I turn next to the Court of Appeal's conclusion that seeking and obtaining the DIP orders without notice to the plan beneficiaries and seeking and obtaining the sale approval order constituted breaches of fiduciary duty.

213 To begin, I agree with the Court of Appeal that "just because the initial decision to commence *CCAA* proceedings is solely a corporate one ... does not mean that all subsequent decisions made during the proceedings are also solely corporate ones": para. 132. It was at this point that Indalex's interests as a corporation came into conflict with its duties as a pension plan administrator.

214 The DIP orders could easily have the effect of making it impossible for Indalex to satisfy its funding obligations to the plan beneficiaries. When Indalex, through the exercise of business judgment, sought *CCAA* orders that would or might have this effect, it was in conflict with its duty as plan administrator to ensure that all contributions were paid when due.

215 I do not think, however, that the simple existence of this conflict of interest and duty, on its own, was a breach of fiduciary duty in these circumstances. As discussed earlier, the *PBA* expressly permits an employer to be a pension administrator and the statutory provisions about conflict of interest must be understood and applied in light of that fact. Moreover, an independent plan administrator would have no decision-making role with respect to the conduct of *CCAA* proceedings. So in my view, the difficulty that arose here was not the existence of the conflict itself, but Indalex's failure to take steps so that the plan beneficiaries would have the opportunity to have their interests protected in the *CCAA* proceedings as if the plans were administered by an independent administrator. In short, the difficulty was not the existence of the conflict, but the failure to address it.

216 Despite Indalex's failure to address its conflict of interest, the plan beneficiaries, through their own efforts, were represented at subsequent steps in the *CCAA* proceedings. The effect of Indalex's breach was therefore mitigated, a point which I will discuss in greater detail when I turn to the issue of the constructive trust.

217 Nevertheless, for the purposes of providing some guidance for future *CCAA* proceedings, I take this opportunity to briefly address what an employer-administrator can do to respond to these sorts of conflicts. First and foremost, an employer-administrator who finds itself in a conflict must bring the conflict to the attention of the *CCAA* judge. It is not enough to include the beneficiaries in the list of creditors; the judge must be made aware that the debtor, as an administrator of the plan is, or may be, in a conflict of interest.

218 Given their expertise and their knowledge of particular cases, *CCAA* judges are well placed to decide how best to ensure that the interests of the plan beneficiaries are fully represented in the context of "real-time" litigation under the *CCAA*. Knowing of the conflict, a *CCAA* judge might consider it appropriate to appoint an independent administrator or independent counsel as *amicus curiae* on terms appropriate to the particular case. Indeed, there have been cases in which representative counsel have been appointed to represent tort claimants, clients, pensioners and non-unionized employees in *CCAA* proceedings on terms determined by the judge: *Rescue!*, at p. 278; see, e.g., *First Leaside Wealth Management Inc., Re*, 2012 ONSC 1299 (Ont. S.C.J. [Commercial List]); *Nortel Networks Corp., Re* (2009), 75 C.C.P.B. 206 (Ont. S.C.J. [Commercial List]). In other circumstances, a *CCAA* judge might find that it is feasible to give notice

directly to the pension beneficiaries. In my view, notice, though desirable, may not always be feasible and decisions on such matters should be left to the judicial discretion of the *CCAA* judge. Alternatively, the judge might consider limiting draws on the DIP facility until notice can be given to the beneficiaries: *Royal Oak Mines Inc., Re* (1999), 6 C.B.R. (4th) 314 (Ont. Gen. Div. [Commercial List]), at para. 24. Ultimately, the appropriate response or combination of responses should be left to the discretion of the *CCAA* judge in a particular case. The point, as well expressed by the Court of Appeal, is that the insolvent corporation which is also a pension plan administrator cannot "simply ignore its obligations as the Plans' administrator once it decided to seek *CCAA* protection": para. 132.

219 I conclude that the Court of Appeal erred in finding that Indalex breached its fiduciary duties as plan administrator by taking the various steps it did in the *CCAA* proceedings. However, I agree with the Court of Appeal that it breached its fiduciary duty by failing to take steps to ensure that the plan beneficiaries had the opportunity to be as fully represented in those proceedings as if there had been an independent plan administrator.

(iii) The Bankruptcy Motion

220 At the same time Indalex applied for the sale approval order, it also applied to lift the *CCAA* stay so that it could file an assignment into bankruptcy. As Campbell J. put it, this was done "to ensure the priority regime [it] urged as the basis for resisting the deemed trust": para. 52. The Court of Appeal concluded that this was a breach of Indalex's fiduciary duties because the motion was brought "with the intention of defeating the deemed trust claims and ensuring that the Reserve Fund was transferred to [the U.S. debtors]": para. 139. I respectfully disagree.

221 It was certainly open to Indalex as an employer to bring a motion to voluntarily enter into bankruptcy. A pension plan administrator has no responsibility or authority in relation to that step. The problem here is not that the motion was brought, but that Indalex failed to meaningfully address the conflict between its corporate interests and its duties as plan administrator.

222 To sum up, I conclude that Indalex did not breach any fiduciary duty by undertaking *CCAA* proceedings or seeking the relief that it did. The breach arose from Indalex's failure to ensure that its pension plan beneficiaries had the opportunity to have their interests effectively represented in the insolvency proceedings, particularly when Indalex sought the DIP financing approval, the sale approval and the motion for bankruptcy.

(3) Was Imposing a Constructive Trust Appropriate in This Case?

223 The next issue is whether a remedial constructive trust is, as the Court of Appeal concluded, an appropriate remedy in response to the breach of fiduciary duty.

224 The Court of Appeal exercised its discretion to impose a constructive trust and its exercise of this discretion is entitled to deference. Only if the discretion has been exercised on the basis of an erroneous principle should the order be overturned on appeal: *Donkin v. Bugoy*, [1985] 2 S.C.R. 85 (S.C.C.), cited in *Soulos v. Korkontzilas*, [1997] 2 S.C.R. 217 (S.C.C.), at para. 54, by Sopinka J. (dissenting, but not on this point). In my respectful view, the Court of Appeal's erroneous conclusions about the scope of a plan administrator's fiduciary duties require us to examine the constructive trust issue anew. Moreover, the Court of Appeal, in my respectful opinion, erred in principle in finding that the asset in this case resulted from the breach of fiduciary duty such that it would be unjust for the party in breach to retain it.

225 As noted earlier, the Court of Appeal imposed a constructive trust in favour of the plan beneficiaries with respect to funds retained in the reserve fund equal to the total amount of the wind-up deficiency for both plans. In other words, upon insolvency of Indalex, the plan beneficiaries received 100 cents on the dollar as a result of a judicially imposed trust taking priority over secured creditors, and indeed over other unsecured creditors, assuming there was no deemed trust for the executive plan.

226 I have explained earlier why I take a different view than did the Court of Appeal of Indalex's breach of fiduciary duty. In light of what I conclude was the breach which could give rise to a remedy, my view is that the constructive

trust cannot properly be imposed in this case and the Court of Appeal erred in principle in exercising its discretion to impose this remedy.

227 I part company with the Court of Appeal with respect to several aspects of its constructive trust analysis; it is far from clear to me that any of the conditions for imposing a constructive trust were present here. However, I will only address one of them in detail. As I will explain, a remedial constructive trust for a breach of fiduciary duty is only appropriate if the wrongdoer's acts give rise to an identifiable asset which it would be unjust for the wrongdoer (or sometimes a third party) to retain. In my view, Indalex's failure to meaningfully address conflicts of interest that arose during the *CCAA* proceedings did not result in any such asset.

228 As the Court of Appeal recognized, the governing authority concerning the remedial constructive trust outside the domain of unjust enrichment is *Soulos*. In *Soulos*, McLachlin J. (as she then was) wrote that a constructive trust may be an appropriate remedy for breach of fiduciary duty: paras. 19-45. She laid out four requirements that should generally be satisfied before a constructive trust will be imposed: para. 45. Although, in *Soulos*, McLachlin J. was careful to indicate that these are conditions that "generally" must be present, all parties in this case accept that these four conditions must be present before a remedial constructive trust may be ordered for breach of fiduciary duty. The four conditions are these:

> (1) The defendant must have been under an equitable obligation, that is, an obligation of the type that courts of equity have enforced, in relation to the activities giving rise to the assets in his hands;
>
> (2) The assets in the hands of the defendant must be shown to have resulted from deemed or actual agency activities of the defendant in breach of his equitable obligation to the plaintiff;
>
> (3) The plaintiff must show a legitimate reason for seeking a proprietary remedy, either personal or related to the need to ensure that others like the defendant remain faithful to their duties and;
>
> (4) There must be no factors which would render imposition of a constructive trust unjust in all the circumstances of the case; e.g., the interests of intervening creditors must be protected. [para. 45]

229 My concern is with respect to the second requirement, that is, whether the breach resulted in an asset in the hands of Indalex. A constructive trust arises when the law imposes upon a party an obligation to hold specific property for another: D. W. M. Waters, M. R. Gillen and L. D. Smith, *Waters' Law of Trusts in Canada* (3rd ed. 2005), at p. 454 ("*Waters*"). The purpose of imposing a constructive trust as a remedy for a breach of duty or unjust enrichment is to prevent parties "from retaining property which in 'good conscience' they should not be permitted to retain": *Soulos*, *at* para. 17. It follows, therefore, that while the remedial constructive trust may be appropriate in a variety of situations, the wrongdoer's conduct toward the plaintiff must generally have given rise to assets in the hands of the wrongdoer (or of a third party in some situations) which cannot in justice and good conscience be retained. That cannot be said here.

230 The Court of Appeal held that this second condition was present because "[t]he assets [i.e. the reserve fund monies] are directly connected to the process in which Indalex committed its breaches of fiduciary obligation": para. 204. Respectfully, this conclusion is based on incorrect legal principles. To satisfy this second condition, it must be shown that the breach *resulted in* the assets being in Indalex's hands, not simply, as the Court of Appeal thought, that there was a "connection" between the assets and "the process" in which Indalex breached its fiduciary duty. Recall that in *Soulos* itself, *the defendant's acquisition of the disputed property was a direct result of his breach of his duty of loyalty* to the plaintiff: para. 48. This is not our case. As the Court observed, in the context of an unjust enrichment claim in *Peter v. Beblow*, [1993] 1 S.C.R. 980 (S.C.C.), at p. 995;

> ... for a constructive trust to arise, the plaintiff must establish a direct link to the property which is the subject of the trust by reason of the plaintiff's contribution.

231 While cases of breach of fiduciary duty are different in important ways from cases of unjust enrichment, La Forest J. (with Lamer J. concurring on this point) applied a similar standard for proprietary relief in *Lac Minerals*, a

case in which wrongdoing was the basis for the constructive trust: p. 678, quoted in *Waters*', at p. 471. His comments demonstrate the high standard to be met in order for a constructive trust to be awarded:

> The constructive trust awards a right in property, but that right can only arise once a right to relief has been established. In the vast majority of cases a constructive trust will not be the appropriate remedy.... [A] constructive trust should only be awarded if there is reason to grant to the plaintiff the additional rights that flow from recognition of a right of property. [p. 678]

232 The relevant breach in this case was the failure of Indalex to meaningfully address the conflicts of interest that arose in the course of the *CCAA* proceedings. (The breach that arose with respect to the bankruptcy motion is irrelevant because that motion was not addressed and therefore could not have given rise to the assets.) The "assets" in issue here are the funds in the reserve fund which were retained from the proceeds of the sale of Indalex as a going concern. Indalex's breach in this case did not give rise to the funds which were retained by the Monitor in the reserve fund.

233 Where does the respondents' claim of a procedural breach take them? Taking their position at its highest, it would be that the DIP approval proceedings and the sale would not have been approved. This position, however, is fatally flawed. Turning first to the DIP approval, there is no evidence to support the view that, had Indalex addressed its conflict in the DIP approval process, the DIP financing would have been rejected or granted on different terms. The *CCAA* judge, being fully aware of the pension situation, ruled that the DIP financing was "required", that there was "no other alternative available to the Applicants for a going concern solution", and that "the benefit to stakeholders and creditors of the DIP Financing outweighs any potential prejudice to unsecured creditors that may arise as a result of the granting of super-priority secured financing": endorsement of Morawetz J., April 8, 2009, at paras. 6 and 9. In effect, the respondents are claiming funds which arose only because of the process to which they now object. Taking into account that there was an absence of any evidence that more favourable financing terms were available, that the judge's decision was made with full knowledge of the plan beneficiaries' claims, and that he found that the DIP financing was necessary, the respondents' contention is not only speculative, it also directly contradicts the conclusions of the *CCAA* judge.

234 Turning next to the sale approval and the approval of the distribution of the assets, it is clear that the plan beneficiaries had independent representation but that this did not change the result. Although, perhaps with little thanks to Indalex, the interests of both plans were fully and ably represented before Campbell J. at the sale approval and interim distribution motions in July of 2009.

235 The executive plan retirees, through able counsel, objected to the sale on the basis that the liquidation values set out in the Monitor's seventh report would provide greater return for unsecured creditors. The motions judge dismissed this objection "on the basis *that there was no clear evidence to support the proposition and in any event the transaction as approved did preserve value for suppliers, customers and preserve approximately 950 jobs*"*:* trial reasons of Campbell J., at para. 13 (emphasis added). Both the executive plan retirees and the USW, which represented some members of the salaried plan, objected to the proposed distribution of the sale proceeds. In response to this objection, it was agreed that those objections would be heard promptly and that the Monitor would retain sufficient funds to satisfy the pensioners' claims if they were upheld: trial reasons of Campbell J., at paras. 14-16.

236 There is no evidence to support the contention that Indalex's breach of its fiduciary duty as pension administrator resulted in the assets retained in the reserve fund. I therefore conclude that the Court of Appeal erred in law in finding that the second condition for imposing a constructive trust — i.e. that the assets in the defendant's hands must be shown to have resulted from the defendant's breaches of duty to the plaintiff — had been established.

237 I would add only two further comments with respect to the constructive trust. A major concern of the Court of Appeal was that unless a constructive trust were imposed, the reserve funds would end up in the hands of other Indalex entities which were not operating at arm's length from Indalex. The U.S. debtors claimed the reserve fund because it had paid on its guarantee of the DIP loans and thereby stepped into the shoes of the DIP lender with respect to priority. Sun Indalex claims in the U.S. bankruptcy proceedings as a secured creditor of the U.S. debtors. The Court of Appeal put

its concern this way: "To permit Sun Indalex to recover on behalf of [the U.S. debtors] would be to effectively permit the party who breached its fiduciary obligations to take the benefit of those breaches, to the detriment of those to whom the fiduciary obligations were owed": para. 199.

238 There are two difficulties with this approach, in my respectful view. The U.S. debtors paid real money to honour their guarantees. Moreover, unless there is a legal basis for ignoring the separate corporate personality of separate corporate entities, those separate corporate existences must be respected. Neither the parties nor the Court of Appeal advanced such a reason.

239 Finally, I would note that imposing a constructive trust was wholly disproportionate to Indalex's breach of fiduciary duty. Its breach — the failure to meaningfully address the conflicts of interest that arose during the *CCAA* process — had no adverse impact on the plan beneficiaries in the sale approval process which gave rise to the "asset" in issue. Their interests were fully represented and carefully considered before the sale was approved and the funds distributed. The sale was nonetheless judged to be in the best interests of the corporation, all things considered. In my respectful view, imposing a $6.75 million penalty on the other creditors as a remedial response to this breach is so grossly disproportionate to the breach as to be unreasonable.

240 A judicially ordered constructive trust, imposed long after the fact, is a remedy that tends to destabilize the certainty which is essential for commercial affairs and which is particularly important in financing a workout for an insolvent corporation. To impose a constructive trust in response to a breach of fiduciary duty to ensure for the plan beneficiaries some procedural protections that they in fact took advantage of in any case is an unjust response in all of the circumstances.

241 I conclude that a constructive trust is not an appropriate remedy in this case and that the Court of Appeal erred in principle by imposing it.

C. Third Issue: Did the Court of Appeal Err in Concluding That the Super Priority Granted in the CCAA Proceedings Did Not Have Priority by Virtue of the Doctrine of Federal Paramountcy?

242 Although I disagree with my colleague Justice Deschamps with respect to the scope of the s. 57(4) deemed trust, I agree that if there was a deemed trust in this case, it would be superseded by the DIP loan because of the operation of the doctrine of federal paramountcy: paras. 48-60.

D. Fourth Issue: Did the Court of Appeal Err in its Cost Endorsement Respecting the USW?

(1) Introduction

243 The disposition of costs in the Court of Appeal was somewhat complex. Although the costs appeal relates only to the costs of the USW, it is necessary in order to understand their position to set out the costs order below in full.

244 With respect to the costs of the appeal to the Court of Appeal, no order was made for or against the Monitor due to its prior agreement with the former executives and the USW. However, the court ordered that the former executives and the USW, as successful parties, were each entitled to costs on a partial indemnity basis fixed at $40,000 inclusive of taxes and disbursements from Sun Indalex and the U.S. Trustee, payable jointly and severally: costs endorsement, 2011 ONCA 578, 81 C.B.R. (5th) 165 (Ont. C.A.), at para. 7.

245 Morneau Shepell Ltd., the Superintendent, and the former executives reached an agreement with respect to legal fees and disbursements and the Court of Appeal approved that agreement. The former executives received full indemnity legal fees and disbursements in the amount of $269,913.78 to be paid from the executive plan attributable to each of the 14 former executives' accrued pension benefits, allocated among the 14 former executives in relation to their pension entitlement from the executive plan. In other words, the costs would not be borne by the other three members of the executive plan who did not participate in the proceedings: C.A. costs endorsement, at para. 2. The costs of the appeal

payable by Sun Indalex and the U.S. Trustee were to be paid into the fund of the executive plan and allocated among the 14 former executives in relation to their pension entitlement from the executive plan.

246 USW sought an order for payment of its costs from the fund of the salaried plan. However, the Court of Appeal declined to make such an order because the USW was in a "materially different position" than that of the former executives: costs endorsement, at para. 3. The latter were beneficiaries to the pension fund (14 of the 17 members of the plan), and they consented to the payment of costs from their individual benefit entitlements. Those who had not consented would not be affected by the payment. In contrast, the USW was the bargaining agent (not the beneficiary) for only 7 of the 169 beneficiaries of the salaried plan, none of whom was given notice of, or consented to, the payment of legal costs from the salaried plan. Moreover, the USW sought and seeks an order that its costs be paid out of the fund. This request is significantly different than the order made in favour of the former executives. The former executives explicitly ensured that their choice to pursue the litigation would not put at risk the pension benefits of those members who did not retain counsel even though of course those members would benefit in the event the litigation was successful. The USW is not proposing to insulate the 162 members whom it does not represent from the risk of litigation; it seeks an order requiring all members to share the risk of the litigation even though it represents only 7 of the 169. The proposition advanced by the USW was thus materially different from that advanced on behalf of the executive plan and approved by the court.

(2) Standard of Review

247 In *Kerry (Canada) Inc. v. Ontario (Superintendent of Financial Services)*, 2009 SCC 39, [2009] 2 S.C.R. 678 (S.C.C.), Rothstein J. held that "costs awards are quintessentially discretionary": para. 126. Discretionary costs decisions should only be set aside on appeal if the court below "has made an error in principle or if the costs award is plainly wrong": *Hamilton v. Open Window Bakery Ltd.* (2003), 2004 SCC 9, [2004] 1 S.C.R. 303 (S.C.C.), at para. 27.

(3) Analysis

248 I do not see any basis to interfere with the Court of Appeal's costs endorsement in this case. In my view, the USW's submissions are largely based on an inaccurate reading of the Court of Appeal's costs endorsement. Contrary to what the USW submits, the Court of Appeal did *not* require the consent of plan beneficiaries as a prerequisite to ordering payment of costs from the fund. Nor is it correct to suggest that the costs endorsement would "restrict recovery of beneficiary costs to instances when there is a surplus in the pension trust fund" or "preclude financing of beneficiary action when a fund is in deficit": USW factum, at paras. 71 and 76. Nor would I read the Court of Appeal's brief costs endorsement as laying down a rule that a union representing pension beneficiaries cannot recover costs from the fund because the union itself is not a beneficiary.

249 The premise of the USW's appeal appears to be that it was entitled to costs because it met what it refers to in its submissions as the Costs Payment Test and that if the executive plan members got their costs out of their pension fund, the union should get its costs out of the salaried employees' pension fund. Respectfully, I do not accept the validity of either premise.

250 The decision whether to award costs from the pension fund remains a discretionary matter. In *Nolan*, Rothstein J. surveyed the various factors that courts have taken into account when deciding whether to award a litigant its costs out of a pension trust. The first broad inquiry considered in *Nolan* was into whether the litigation concerned the due administration of the trust. In connection with this inquiry, courts have considered the following factors: (1) whether the litigation was primarily about the construction of the plan documents; (2) whether it clarified a problematic area of the law; (3) whether it was the only means of clarifying the parties' rights; (4) whether the claim alleged maladministration; and (5) whether the litigation had no effect on other beneficiaries of the trust fund: *Nolan*, at para. 126.

251 The second broad inquiry discussed in *Nolan* was whether the litigation was ultimately adversarial: para. 127. The following factors have been considered: (1) whether the litigation included allegations by an unsuccessful party of a

breach of fiduciary duty; (2) whether the litigation only benefited a class of members and would impose costs on other members if successful; and (3) whether the litigation had any merit.

252 I do not think that it is correct to elevate these two inquiries (which constitute the Costs Payment Test articulated by the USW) to a test for entitlement to costs in the pension context. The factors set out in *Nolan* and other cases cited therein are best understood as highly relevant considerations guiding the exercise of judicial discretion with respect to costs.

253 The litigation undertaken here raised novel points of law with all of the uncertainty and risk inherent in such an undertaking. The Court of Appeal in essence decided that the USW, representing only 7 of 169 members of the plan, should not without consultation be able to in effect impose the risks of that litigation on all of the plan members, the vast majority of whom were not union members. Whatever arguments might be raised against the Court of Appeal's decision in light of the success of the litigation and the sharing by all plan members of the benefits, the failure of the litigation seems to me to leave no basis to impose the cost consequences of taking that risk on all of the plan members of an already underfunded plan.

254 The second premise of the USW appeal appears to be that if the executive plan members have their costs paid out of the fund, so too should the salaried plan members. Respectfully, however, this is not an accurate statement of the order made with respect to the executive plan.

255 The Court of Appeal's order with respect to the executive plan meant that only the pension fund attributable to those members of the plan who actually supported the litigation — the vast majority I would add — would contribute to the costs of the litigation even though all members of the plan would benefit in the case of success. As the Court of Appeal noted:

> The individual represented Retirees, who comprise 14 of 17 members of the Executive Plan, have consented to the payment of costs from their individual benefit entitlements. Those who have not consented will not be affected by the payment. [Costs endorsement, at para. 3]

256 The Court of Appeal therefore approved an agreement as to costs which did not put at further risk the pension funds available to satisfy the pension entitlements of those who did not support the litigation. Thus, the Court of Appeal did not apply what the USW refers to as the Costs Payment Test to the executive plan because the costs order was the product of agreement and did not order payment of costs out of the fund as a whole.

257 In the case of the USW request, there was no such agreement and no such limitation of risk to the supporters of the litigation.

258 I see no error in principle in the Court of Appeal's refusal to order the USW costs to be paid out of the pension fund, particularly in light of the disposition of the appeal to this Court. I would dismiss the USW costs appeal but without costs.

IV. Disposition

259 I would allow the Sun Indalex, FTI Consulting and George L. Miller appeals and, except as noted below, I would set aside the orders of the Ontario Court of Appeal and restore the February 18, 2010 orders of Campbell J.

260 With respect to costs, I would set aside the Court of Appeal's orders with respect to the costs of the appeals before that court and order that all parties bear their own costs in the Court of Appeal and in this Court.

261 I would not disturb paras. 9 and 10 of the order of the Court of Appeal in the former executives' appeal so that the full indemnity legal fees and disbursements of the former executives in the amount of $269,913.78 shall be paid from the fund of the executive plan attributable to each of the 14 former executives' accrued pension benefits, and specifically such amounts shall be allocated among the 14 former executives in relation to their pension entitlement from the executive plan and will not be borne by the other three members of the executive plan.

262 I would dismiss the USW costs appeal, but without costs.

***LeBel J.* (dissenting):**

I. Introduction

263 The members of two pension plans set up by Indalex Limited ("Indalex") stand to lose half or more of their pension benefits as a consequence of the insolvency of their employer and of the arrangement approved by the Ontario Superior Court of Justice under the *Companies' Creditors Arrangement Act*, R.S.C. 1985, c. C-36 ("*CCAA*"). The Court of Appeal for Ontario found that the members were entitled to a remedy. For different and partly conflicting reasons, my colleagues Justices Deschamps and Cromwell would hold that no remedy is available to them. With all due respect for their opinions, I would conclude, like the Court of Appeal, that the remedy of a constructive trust is open to them and should be imposed in the circumstances of this case, for the following reasons.

264 I do not intend to summarize the facts of this case, which were outlined by my colleagues. I will address these facts as needed in the course of my reasons. Before moving to my areas of disagreement with my colleagues, I will briefly indicate where and to what extent I agree with them on the relevant legal issues.

265 Like my colleagues, I conclude that no deemed trust could arise under s. 57(4) of the *Pension Benefits Act*, R.S.O. 1990, c. P.8 ("*PBA*"), in the case of the Executive Plan because this plan had not been wound up when the *CCAA* proceedings were initiated. In the case of the Salaried Employees Plan, I agree with Deschamps J. that a deemed trust arises in respect of the wind-up deficiency. But, like her, I accept that the debtor-in-possession ("DIP") super priority prevails by reason of the application of the federal paramountcy doctrine. I also agree that the costs appeal of the United Steelworkers should be dismissed.

266 But, with respect for the opinions of my colleagues, I take a different view of the nature and extent of the fiduciary duties of an employer who elects to act as administrator of a pension plan governed by the *PBA*. This dual status does not entitle the employer to greater leniency in the determination and exercise of its fiduciary duties or excuse wrongful actions. On the contrary, as we shall see below, I conclude that Indalex not only neglected its obligations towards the beneficiaries, but actually took a course of action that was actively inimical to their interests. The seriousness of these breaches amply justified the decision of the Court of Appeal to impose a constructive trust. To that extent, I propose to uphold the opinion of Gillese J.A. and the judgment of the Court of Appeal (2011 ONCA 265, 104 O.R. (3d) 641).

II. The Employer as Administrator of a Pension Plan: Its Fiduciary Duties

267 Before entering into an analysis of the obligations of an employer as administrator of a pension plan under the *PBA*, it is necessary to consider the position of the beneficiaries. Who are they? At what stage are they in their lives? What are their vulnerabilities? A fiduciary relationship is a relationship, grounded in fact and law, between a vulnerable beneficiary and a fiduciary who holds and may exercise power over the beneficiary in situations recognized by law. Any analysis of such a relationship requires careful consideration of the characteristics of the beneficiary. It ought not stop at the level of a theoretical and detached approach that fails to address how, very concretely, this relationship works or can be twisted, perverted or abused, as was the situation in this case.

268 The beneficiaries were in a very vulnerable position relative to Indalex. They did not enjoy the protection that the existence of an independent administrator might have given them. They had no say and no input in the management of the plans. The information about the plans and their situation came from Indalex in its dual role as employer and manager of the plans. Their particular vulnerability arose from their relationship with Indalex, acting both as their employer and as the administrator of their retirement plans. Their vulnerability was substantially a consequence of that specific relationship (*Perez v. Galambos*, 2009 SCC 48, [2009] 3 S.C.R. 247 (S.C.C.), at para. 68, *per* Cromwell J.). The nature of this relationship had very practical consequences on their interests. For example, as Gillese J.A. noted in her reasons (at para. 40) the consequences of the decisions made in the course of management of the plan and during the

CCAA proceedings signify that the members of the Executive Plan stand to lose one-half to two-thirds of their retirement benefits, unless additional money is somehow paid into the plan. These losses of benefits are, in all probability, permanent in the case of the beneficiaries who have already retired or who are close to retirement. They deeply affect their lives and expectations. For most of them, what is lost is lost for good. No arrangement will allow them to get a start on a new life. We should not view the situation of the beneficiaries as regrettable but unavoidable collateral damage arising out of the ebbs and tides of the economy. In my view, the law should give the members some protection, as the Court of Appeal intended when it imposed a constructive trust.

269 Indalex was in a conflict of interest from the moment it started to contemplate putting itself under the protection of the *CCAA* and proposing an arrangement to its creditors. From the corporate perspective, one could hardly find fault with such a decision. It was a business decision. But the trouble is that at the same time, Indalex was a fiduciary in relation to the members and retirees of its pension plans. The "two hats" analogy offers no defence to Indalex. It could not switch off the fiduciary relationship at will when it conflicted with its business obligations or decisions. Throughout the arrangement process and until it was replaced by an independent administrator (Morneau Shepell Ltd.) it remained a fiduciary.

270 It is true that the *PBA* allows an employer to act as an administrator of a pension plan in Ontario. In such cases, the legislature accepts that conflicts of interest may arise. But, in my opinion, nothing in the *PBA* allows that the employer *qua* administrator will be held to a lower standard or will be subject to duties and obligations that are less stringent than those of an independent administrator. The employer remains a fiduciary under the statute and at common law (*PBA*, s. 22(4)). The employer is under no obligation to assume the burdens of administering the pension plans that it has agreed to set up or that are the legacy of previous decisions. However, if it decides to do so, a fiduciary relationship is created with the expectation that the employer will be able to avoid or resolve the conflicts of interest that might arise. If this proves to be impossible, the employer is still "seized" with fiduciary duties, and cannot ignore them out of hand.

271 Once Indalex had considered the *CCAA* process and decided to proceed in that manner, it should have been obvious that such a move would trigger conflicts of interest with the beneficiaries of the pension plans and that these conflicts would become untenable, as per the terms of s. 22(4) of the *PBA*. Given the nature of its obligations as administrator and fiduciary, it was impossible to wear the "two hats". Indalex had to discharge its corporate duties, but at the same time it had to address its fiduciary obligations to the members and beneficiaries of the plans. I do not fault it for applying under the *CCAA*, but rather for not relinquishing its position as administrator of the plans at the time of the application. It even retained this position once it engaged in the arrangement process. Other conflicts and breaches of fiduciary duties and of fundamental rules of procedural equity in the Superior Court flowed from this first decision. Moreover, Indalex maintained a strongly adversarial attitude towards the interest of the beneficiaries throughout the arrangement process, while it was still, at least in form, the administrator of the plans.

272 The option given to employers to act as administrators of pension plans under the *PBA* does not constitute a licence to breach the fiduciary duties that flow from this function. It should not be viewed as an invitation for the courts to whitewash the consequences of such breaches. The option is predicated on the ability of the employer-administrator to avoid the conflicts of interests that cause these breaches. An employer deciding to assume the position of administrator cannot claim to be in the same situation as the Crown when it discharges fiduciary obligations towards certain groups in society under the Constitution or the law. For those cases, the Crown assumes those duties because it is obligated to do so by virtue of its role, not because it chooses to do so. In such circumstances, the Crown must often balance conflicting interests and obligations to the broader society in the discharge of those fiduciary duties (*Elder Advocates of Alberta Society v. Alberta*, 2011 SCC 24, [2011] 2 S.C.R. 261 (S.C.C.), at paras. 37-38). If Indalex found itself in a situation where it had to balance conflicting interests and obligations, as it essentially argues, it could not retain the position of administrator that it had willingly assumed. The solution was not to place its function as administrator and its associated fiduciary duties in abeyance. Rather, it had to abandon this role and diligently transfer its function as manager to an independent administrator.

273 Indalex could apply for protection under the *CCAA*. But, in so doing, it needed to make arrangements to avoid conflicts of interests. As nothing was done, the members of the plans were left to play catch up as best they could when the process that put in place the DIP financing and its super priority was initiated. The process had been launched in such a way that it took significant time before the beneficiaries could effectively participate in the process. In practice, the United Steelworkers union, which represented only a small group of the members of the Salaried Employees Plan, acted for them after the start of the procedures. The members of the Executive Plan hired counsel who appeared for them. But, throughout, there were problems with notices, delays and the ability to participate in the process. Indeed, during the *CCAA* proceedings, the Monitor and Indalex seemed to have been more concerned about keeping the members of the plans out of the process rather than ensuring that their voices could be heard. Two paragraphs of the submissions to this Court by Morneau Shepell Ltd., the subsequently appointed administrator of the plan, aptly sums up the behaviour of Indalex and the Monitor towards the beneficiaries, whose representations were always deemed to be either premature or late:

> When counsel for the Retirees again appeared at a motion to approve the bidding procedure, his objections were considered premature:
>
> > In my view, the issues raised by the retirees do not have any impact on the Bidding Procedures. The issues can be raised by the retirees on any application to approve a transaction — but that is for another day. [(2009), 79 C.C.P.B. 101 (Ont. S.C.J.), at para. 10, *per* Morawetz J.]
>
> Only when counsel appeared at the sale approval motion, as directed by the motions judge, were the concerns of the pension plan beneficiaries heard. At that time, the Appellants complain, the beneficiaries were too late and their motion constituted a collateral attack on the original DIP Order. However, it cannot be the case that stakeholder groups are too early, until they are too late. [Factum, at paras. 54-55]

274 I must also mention the failed attempt to assign Indalex in bankruptcy once the sale of its business had been approved. One of the purposes of this action was essentially to harm the interests of the members of the plans. At the time, Indalex was still wearing its two hats, at least from a legal perspective. But its duties as a fiduciary were clearly not at the forefront of its concerns. There were constant conflicts of interest throughout the process. Indalex did not attempt to resolve them; it brushed them aside. In so acting, it breached its duties as a fiduciary and its statutory obligations under s. 22(4) *PBA*.

III. Procedural Fairness in CCAA Proceedings

275 The manner in which this matter was conducted in the Superior Court was, at least partially, the result of Indalex disregarding its fiduciary duties. The procedural issues that arose in that court did not assist in mitigating the consequences of these breaches. It is true that, in the end, the beneficiaries obtained, or were given, some information pertaining to the proceedings and that counsel appeared on their behalf at various stages of the proceedings. However, the basic problem is that the proceedings were not conducted according to the spirit and principles of the Canadian system of civil justice.

276 I accept that those procedures are often urgent. The situation of a debtor requires quick and efficient action. The turtle-like pace of some civil litigation would not meet the needs of the application of the *CCAA*. However, the conduct of proceedings under this statute is not solely an administrative process. It is also a judicial process conducted according to the tenets of the adversarial system. The fundamentals of such a system must not be ignored. All interested parties are entitled to a fair procedure that allows their voices to be raised and heard. It is not an answer to these concerns to say that nothing else could be done, that no other solution would have been better, that, in substance, hearing the members would have been a waste of time. In all branches of procedure whether in administrative law, criminal law or civil action, the rights to be informed and to be heard in some way remain fundamental principles of justice. Those principles retain their place in the *CCAA*, as some authors and judges have emphasized (J. P. Sarra, *Rescue! The*

Companies' Creditors Arrangement Act (2007), at pp. 55-56; *Royal Oak Mines Inc., Re* (1999), 7 C.B.R. (4th) 293 (Ont. Gen. Div. [Commercial List]), at para. 5, *per* Farley J.). This was not done in this case, as my colleagues admit, while they downplay the consequences of these procedural flaws and breaches.

IV. Imposing a Constructive Trust

277 In this context, I see no error in the decision of the Court of Appeal to impose a constructive trust (paras. 200-207). It was a fair decision that met the requirements of justice, under the principles set out by our Court in *Canson Enterprises Ltd. v. Boughton & Co.*, [1991] 3 S.C.R. 534 (S.C.C.), and in *Soulos v. Korkontzilas*, [1997] 2 S.C.R. 217 (S.C.C.). The remedy of a constructive trust was justified in order to correct the wrong caused by Indalex (*Soulos*, at para. 36, *per* McLachlin J. (as she then was)). The facts of the situation met the four conditions that generally justify the imposition of a constructive trust (*Soulos*, at para. 45), as determined by Justice Gillese in her reasons, at paras. 203 and 204: (1) the defendant was under an equitable obligation in relation to the activities giving rise to the assets in his or her hands; (2) the assets in the hands of the defendant were shown to have resulted from deemed or actual agency activities of the defendant in breach of his or her equitable obligation to the plaintiff; (3) the plaintiff has shown a legitimate reason for seeking a proprietary remedy, either personal or related to the need to ensure that others like the defendants remain faithful to their duties; and (4) there are no factors which would render imposition of a constructive trust unjust in all the circumstances of the case, such as the protection of the interests of intervening creditors.

278 In crafting such a remedy, the Court of Appeal was relying on the inherent powers of the courts to craft equitable remedies, not only in respect of procedural issues, but also of substantive questions. Section 9 of the *CCAA* is broadly drafted and does not deprive courts of their power to fill in gaps in the law when this is necessary in order to grant justice to the parties (G. R. Jackson and J. Sarra, "Selecting the Judicial Tool to get the Job Done: An Examination of Statutory Interpretation, Discretionary Power and Inherent Jurisdiction in Insolvency Matters", in J. P. Sarra, ed., *Annual Review of Insolvency Law, 2007* (2008), 41, at pp. 78-79).

279 The imposition of the trust did not disregard the different corporate personalities of Indalex and Indalex U.S. It properly acknowledged the close relationship between the two companies, the second in effect controlling the first. This relationship could and needed to be taken into consideration in order to determine whether a constructive trust was a proper remedy.

280 For these reasons, I would uphold the imposition of a constructive trust and I would dismiss the appeal with costs to the respondents.

Order accordingly.

Ordonnance en conséquence.

Appendix

The Pension Benefits Amendment Act, 1973, S.O. 1973, c. 113

6. The said Act is amended by adding thereto the following sections:

23*a*. — (1) <u>Any sum received by an employer from an employee</u> pursuant to an arrangement for the payment of such sum by the employer into a pension plan as the employee's contribution thereto shall be <u>deemed to be held by the employer in trust</u> for payment of the same after his receipt thereof into the pension plan as the employee's contribution thereto and the employer shall not appropriate or convert any part thereof to his own use or to any use not authorized by the trust.

(2) For the purposes of subsection 1, any sum withheld by an employer, whether by payroll deduction or otherwise, from moneys payable to an employee shall be deemed to be a sum received by the employer from the employee.

(3) Any sum required to be paid into a pension plan by an employer as the employer's contribution to the plan shall, when due under the plan, be deemed to be held by the employer in trust for payment of the same into the plan in accordance with the plan and this Act and the regulations as the employer's contribution and the employer shall not appropriate or convert any part of the amount required to be paid to the fund to his own use or to any use not authorized by the terms of the pension plan.

Pension Benefits Act, R.S.O. 1980, c. 373

21. . . .

(2) Upon the termination or winding up of a pension plan filed for registration as required by section 17, the employer is liable to pay all amounts that would otherwise have been required to be paid to meet the tests for solvency prescribed by the regulations, up to the date of such termination or winding up, to the insurer, administrator or trustee of the pension plan.

. . . . .

23. — (1) Where a sum is received by an employer from an employee under an arrangement for the payment of the sum by the employer into a pension plan as the employee's contribution thereto, the employer shall be deemed to hold the sum in trust for the employee until the sum is paid into the pension plan whether or not the sum has in fact been kept separate and apart by the employer and the employee has a lien upon the assets of the employer for such amount that in the ordinary course of business would be entered in books of account whether so entered or not.

. . . . .

(3) Where an employer is required to make contributions to a pension plan, he shall be deemed to hold in trust for the members of the plan an amount calculated in accordance with subsection (4), whether or not,

(a) the employer contributions are payable into the plan under the terms of the plan or this Act; or

(b) the amount has been kept separate and apart by the employer,

and the members have a lien upon the assets of the employer in such amount that in the ordinary course of business would be entered into the books of account whether so entered or not.

(4) For the purpose of determining the amount deemed to be held in trust under subsection (3) on a specific date, the calculation shall be made as if the plan had been wound up on that date.

. . . . .

32. In addition to any amounts the employer is liable to pay under subsection 21 (2), where a defined benefit pension plan is terminated or wound up or the plan is amended so that it is no longer a defined benefit pension plan, the employer is liable to the plan for the difference between,

(a) the value of the assets of the plan; and

(b) the value of pension benefits guaranteed under subsection 31 (1) and any other pension benefit vested under the terms of the plan,

and the employer shall make payments to the insurer, trustee or administrator of the pension plan to fund the amount owing in such manner as is prescribed by regulation.

Pension Benefits Amendment Act, 1983, S.O. 1983, c. 2

2. Subsection 21 (2) of the said Act is repealed and the following substituted therefor:

(2) Upon the termination or winding up of a registered pension plan, the employer of employees covered by the pension plan shall pay to the administrator, insurer or trustee of the pension plan,

(a) an amount equal to,

(i) the current service cost, and

(ii) the special payments prescribed by the regulations,

that have accrued to and including the date of the termination or winding up but, under the terms of the pension plan or the regulations, are not due on that date; and

(b) all other payments that, by the terms of the pension plan or the regulations, are due from the employer to the pension plan but have not been paid at the date of the termination or winding up.

(2a) For the purposes of clause (2) (a), the current service cost and special payments shall be deemed to accrue on a daily basis.

3. Section 23 of the said Act is repealed and the following substituted therefor:

23. — (1) Where an employer receives money from an employee under an arrangement that the employer will pay the money into a pension plan as the employee's contribution to the pension plan, the employer shall be deemed to hold the money in trust for the employee until the employer pays the money into the pension plan.

(2) For the purposes of subsection (1), money withheld by an employer, whether by payroll deduction or otherwise, from moneys payable to an employee shall be deemed to be money received by the employer from the employee.

(3) The administrator or trustee of the pension plan has a lien and charge upon the assets of the employer in an amount equal to the amount that is deemed to be held in trust under subsection (1).

(4) An employer who is required by a pension plan to contribute to the pension plan shall be deemed to hold in trust for the members of the pension plan an amount of money equal to the total of,

(a) all moneys that the employer is required to pay into the pension plan to meet,

(i) the current service cost, and

(ii) the special payments prescribed by the regulations,

that are due under the pension plan or the regulations and have not been paid into the pension plan; and

(b) where the pension plan is terminated or wound up, any other money that the employer is liable to pay under clause 21 (2) (a).

(5) The administrator or trustee of the pension plan has a lien and charge upon the assets of the employer in an amount equal to the amount that is deemed to be held in trust under subsection (4).

(6) Subsections (1) and (4) apply whether or not the moneys mentioned in those subsections are kept separate and apart from other money.

. . . . .

8. Sections 32 and 33 of the said Act are repealed and the following substituted therefor:

32. — (1) The employer of employees who are members of a defined benefit pension plan that the employer is bound by or to which the employer is a party and that is partly or wholly wound up shall pay to the administrator, insurer or trustee of the plan an amount of money equal to the amount by which the value of the pension benefits guaranteed by section 31 plus the value of the pension benefits vested under the defined benefit pension plan exceeds the value of the assets of the plan allocated in accordance with the regulations for payment of pension benefits accrued with respect to service in Ontario.

(2) The amount that the employer is required to pay under subsection (1) is in addition to the amounts that the employer is liable to pay under subsection 21 (2).

(3) The employer shall pay the amount required under subsection (1) to the administrator, insurer or trustee of the defined benefit pension plan in the manner prescribed by the regulations.

Pension Benefits Act, 1987, S.O. 1987, c. 35

58. — (1) Where an employer receives money from an employee under an arrangement that the employer will pay the money into a pension fund as the employee's contribution under the pension plan, the employer shall be deemed to hold the money in trust for the employee until the employer pays the money into the pension fund.

. . . . .

(3) An employer who is required to pay contributions to a pension fund shall be deemed to hold in trust for the beneficiaries of the pension plan an amount of money equal to the employer contributions due and not paid into the pension fund.

(4) Where a pension plan is wound up in whole or in part, an employer who is required to pay contributions to the pension fund shall be deemed to hold in trust for the beneficiaries of the pension plan an amount of money equal to employer contributions accrued to the date of the wind up but not yet due under the plan or regulations.

. . . . .

59. — (1) Money that an employer is required to pay into a pension fund accrues on a daily basis.

(2) Interest on contributions shall be calculated and credited at a rate not less than the prescribed rates and in accordance with prescribed requirements.

. . . . .

75. — (1) A member in Ontario of a pension plan whose combination of age plus years of continuous employment or membership in the pension plan equals at least fifty-five, at the effective date of the wind up of the pension plan in whole or in part, has the right to receive,

(a) a pension in accordance with the terms of the pension plan, if, under the pension plan, the member is eligible for immediate payment of the pension benefit;

(b) a pension in accordance with the terms of the pension plan, beginning at the earlier of,

(i) the normal retirement date under the pension plan, or

(ii) the date on which the member would be entitled to an unreduced pension under the pension plan if the pension plan were not wound up and if the member's membership continued to that date; or

(c) a reduced pension in the amount payable under the terms of the pension plan beginning on the date on which the member would be entitled to the reduced pension under the pension plan if the pension plan were not wound up and if the member's membership continued to that date.

. . . . .

76. — (1) Where a pension plan is wound up in whole or in part, the employer shall pay into the pension fund,

(a) an amount equal to the total of all payments that, under this Act, the regulations and the pension plan, are due or that have accrued and that have not been paid into the pension fund; and

(b) an amount equal to the amount by which,

(i) the value of the pension benefits under the pension plan that would be guaranteed by the Guarantee Fund under this Act and the regulations if the Commission declares that the Guarantee Fund applies to the pension plan,

(ii) the value of the pension benefits accrued with respect to employment in Ontario vested under the pension plan, and

(iii) the value of benefits accrued with respect to employment in Ontario resulting from the application of subsection 40 (3) (50 per cent rule) and section 75,

exceed the value of the assets of the pension fund allocated as prescribed for payment of pension benefits accrued with respect to employment in Ontario.

Pension Benefits Act, R.S.O. 1990, c. P.8

57. (1) [Trust property] Where an employer receives money from an employee under an arrangement that the employer will pay the money into a pension fund as the employee's contribution under the pension plan, the employer shall be deemed to hold the money in trust for the employee until the employer pays the money into the pension fund.

(2) [Money withheld] For the purposes of subsection (1), money withheld by an employer, whether by payroll deduction or otherwise, from money payable to an employee shall be deemed to be money received by the employer from the employee.

(3) [Accrued contributions] An employer who is required to pay contributions to a pension fund shall be deemed to hold in trust for the beneficiaries of the pension plan an amount of money equal to the employer contributions due and not paid into the pension fund.

(4) [Wind up] Where a pension plan is wound up in whole or in part, an employer who is required to pay contributions to the pension fund shall be deemed to hold in trust for the beneficiaries of the pension plan an amount of money equal to employer contributions accrued to the date of the wind up but not yet due under the plan or regulations.

. . . . .

58. (1) [Accrual] Money that an employer is required to pay into a pension fund accrues on a daily basis.

(2) [Interest] Interest on contributions shall be calculated and credited at a rate not less than the prescribed rates and in accordance with prescribed requirements.

. . . . .

74. (1) [Activating events] This section applies if a person ceases to be a member of a pension plan on the effective date of one of the following activating events:

1. The wind up of a pension plan, if the effective date of the wind up is on or after April 1, 1987.

2. The employer's termination of the member's employment, if the effective date of the termination is on or after July 1, 2012. However, this paragraph does not apply if the termination occurs in any of the circumstances described in subsection (1.1).

3. The occurrence of such other events as may be prescribed in such circumstances as may be specified by regulation.

(1.1) [Same, termination of employment] Termination of employment is not an activating event if the termination is a result of wilful misconduct, disobedience or wilful neglect of duty by the member that is not trivial and has not been condoned by the employer or if the termination occurs in such other circumstances as may be prescribed.

(1.2) [Exceptions, election by certain pension plans] This section does not apply with respect to a jointly sponsored pension plan or a multi-employer pension plan while an election made under section 74.1 for the plan and its members is in effect.

(1.3) [Benefit] A member in Ontario of a pension plan whose combination of age plus years of continuous employment or membership in the pension plan equals at least 55 on the effective date of the activating event has the right to receive,

(a) a pension in accordance with the terms of the pension plan, if, under the pension plan, the member is eligible for immediate payment of the pension benefit;

(b) a pension in accordance with the terms of the pension plan, beginning at the earlier of,

(i) the normal retirement date under the pension plan, or

(ii) the date on which the member would be entitled to an unreduced pension under the pension plan if the activating event had not occurred and if the member's membership continued to that date; or

(c) a reduced pension in the amount payable under the terms of the pension plan beginning on the date on which the member would be entitled to the reduced pension under the pension plan if the activating event had not occurred and if the member's membership continued to that date.

(2) [Part year] In determining the combination of age plus employment or membership, one-twelfth credit shall be given for each month of age and for each month of continuous employment or membership on the effective date of the activating event.

(3) [Member for 10 years] Bridging benefits offered under the pension plan to which a member would be entitled if the activating event had not occurred and if his or her membership were continued shall be included in calculating the pension benefit under subsection (1.3) of a person who has at least 10 years of continuous employment with the employer or has been a member of the pension plan for at least 10 years.

(4) [Prorated bridging benefit] For the purposes of subsection (3), if the bridging benefit offered under the pension plan is not related to periods of employment or membership in the pension plan, the bridging benefit shall be prorated by the ratio that the member's actual period of employment bears to the period of employment that the member would have to the earliest date on which the member would be entitled to payment of pension benefits and a full bridging benefit under the pension plan if the activating event had not occurred.

(5) [Notice of termination of employment] Membership in a pension plan that is wound up includes the period of notice of termination of employment required under Part XV of the *Employment Standards Act, 2000*.

(6) [Application of subs. (5)] Subsection (5) does not apply for the purpose of calculating the amount of a pension benefit of a member who is required to make contributions to the pension fund unless the member makes the contributions in respect of the period of notice of termination of employment.

(7) [Consent of employer] For the purposes of this section, where the consent of an employer is an eligibility requirement for entitlement to receive an ancillary benefit, the employer shall be deemed to have given the consent.

(7.1) [Consent of administrator, jointly sponsored pension plans] For the purposes of this section, where the consent of the administrator of a jointly sponsored pension plan is an eligibility requirement for entitlement to receive an ancillary benefit, the administrator shall be deemed to have given the consent.

(8) [Use in calculating pension benefit] A benefit described in clause (1.3) (a), (b) or (c) for which a member has met all eligibility requirements under this section shall be included in calculating the member's pension benefit or the commuted value of the pension benefit.

. . . . .

75. (1) [Liability of employer on wind up] Where a pension plan is wound up, the employer shall pay into the pension fund,

(a) an amount equal to the total of all payments that, under this Act, the regulations and the pension plan, are due or that have accrued and that have not been paid into the pension fund; and

(b) an amount equal to the amount by which,

(i) the value of the pension benefits under the pension plan that would be guaranteed by the Guarantee Fund under this Act and the regulations if the Superintendent declares that the Guarantee Fund applies to the pension plan,

(ii) the value of the pension benefits accrued with respect to employment in Ontario vested under the pension plan, and

(iii) the value of benefits accrued with respect to employment in Ontario resulting from the application of subsection 39 (3) (50 per cent rule) and section 74,

exceed the value of the assets of the pension fund allocated as prescribed for payment of pension benefits accrued with respect to employment in Ontario.

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2007 CarswellOnt 46
Ontario Superior Court of Justice [Commercial List]

New Solutions Financial Corp. v. 952339 Ontario Ltd.

2007 CarswellOnt 46, 10 P.P.S.A.C. (3d) 246, 29 C.B.R. (5th) 222

NEW SOLUTIONS FINANCIAL CORPORATION (Plaintiff) and 952339 ONTARIO LIMITED, HOURAS TECHNOLOGY TRANSFERS INC., FLASH HORIZON INC., SAMIR ABOUZAD and RICK VELIANOU (Defendants)

C. Campbell J.

Heard: July 31, 2006
Judgment: January 3, 2007
Docket: 05-CL-6090

Counsel: Christopher Du Vernet, C. McCoogan for Plaintiff
David S. Ward for Interim Receiver, BDO Dunwoody Limited
Various interested parents for themselves

Subject: Insolvency; Corporate and Commercial; Estates and Trusts; Restitution

Headnote

Bankruptcy and insolvency --- Priorities of claims — Unsecured claims — Priority with respect to secured creditors

School was insolvent and interim receiver appointed under Bankruptcy and Insolvency Act operated school until December 2005 — Secured creditor held second mortgage on land and buildings formerly occupied by school and registered valid security interest under Personal Property Security Act ("PPSA") — Parents of students sought refund of tuition and other fees made as advanced payments either to school or interim receiver for period after school ceased to operate — Interim receiver brought motion for directions seeking guidance with respect to distribution of proceeds of sale of school's assets and rights of secured creditor as contrasted with those of parents who made advanced payments for future services — Secured creditor was ruled to have claim in priority to parents — No express trust was created or intended since admission agreement signed by parents provided that fees were to be paid regardless of whether future services were provided to students — No constructive trust existed as remedy for unjust enrichment since parents could not establish absence of juristic reason for enrichment of school and agreement made fees paid to school legally owing as long as school continued to operate — Doctrine of equitable subordination, if it exists in Canadian law, had no application since no evidence existed of any wrongful conduct on part of secured creditor — Secured creditor's interest under PPSA could not be subordinated to unsecured claim of parents since no misconduct by secured creditor existed — Marshalling and set-off had no application.

Personal property security --- Priority of security interest — Security interests versus other interests — Miscellaneous

School fees — School was insolvent and interim receiver appointed under Bankruptcy and Insolvency Act operated school until December 2005 — Secured creditor held second mortgage on land and buildings formerly occupied by school and registered valid security interest under Personal Property Security Act ("PPSA") — Parents of students sought refund of tuition and other fees made as advanced payments either to school or interim receiver for period after school ceased to operate — Interim receiver brought motion for directions seeking guidance with respect to distribution of proceeds of sale of school's assets and rights of secured creditor as contrasted with those of parents who made advanced payments for future services — Secured creditor was ruled to have claim in priority to parents — No express trust was created or intended since admission agreement signed by parents provided that fees were to be paid regardless of whether future services were provided to students — No constructive trust existed as remedy for unjust enrichment since parents could not establish absence of juristic reason for enrichment of school and agreement made fees paid to school legally owing as long as school continued to operate — Doctrine of equitable subordination, if it exists in Canadian law, had no application since no evidence existed of any wrongful conduct on part of secured creditor — Secured creditor's interest under PPSA could not be subordinated to unsecured claim of parents since no misconduct by secured creditor existed — Marshalling and set-off had no application.

Estates and trusts --- Trusts — Express trust — Creation — Three certainties — Intention — General principles

School was insolvent and interim receiver appointed under Bankruptcy and Insolvency Act operated school until December 2005 — Secured creditor held second mortgage on land and buildings formerly occupied by school and registered valid security interest under Personal Property Security Act ("PPSA") — Parents of students sought refund of tuition and other fees made as advanced payments either to school or interim receiver for period after school ceased to operate — Interim receiver brought motion for directions seeking guidance with respect to distribution of proceeds of sale of school's assets and rights of secured creditor as contrasted with those of parents who made advanced payments for future services — Secured creditor was ruled to have claim in priority to parents — No express trust was created or intended since admission agreement signed by parents provided that fees were to be paid regardless of whether future services were provided to students.

Estates and trusts --- Trusts — Constructive trust — General principles

School was insolvent and interim receiver appointed under Bankruptcy and Insolvency Act operated school until December 2005 — Secured creditor held second mortgage on land and buildings formerly occupied by school and registered valid security interest under Personal Property Security Act ("PPSA") — Parents of students sought refund of tuition and other fees made as advanced payments either to school or interim receiver for period after school ceased to operate — Interim receiver brought motion for directions seeking guidance with respect to distribution of proceeds of sale of school's assets and rights of secured creditor as contrasted with those of parents who made advanced payments for future services — Secured creditor was ruled to have claim in priority to parents — No constructive trust existed as remedy for unjust enrichment since parents could not establish absence of juristic reason for enrichment of school and agreement made fees paid to school legally owing as long as school continued to operate.

Restitution and unjust enrichment --- General principles — Requirements for unjust enrichment — No juristic reason for enrichment

School was insolvent and interim receiver appointed under Bankruptcy and Insolvency Act operated school until December 2005 — Secured creditor held second mortgage on land and buildings formerly occupied by school and registered valid security interest under Personal Property Security Act ("PPSA") — Parents of students sought refund of tuition and other fees made as advanced payments either to school or interim receiver for period after school ceased to operate — Interim receiver brought motion for directions seeking guidance with respect to distribution of proceeds of sale of school's assets and rights of secured creditor as contrasted with those of parents who made advanced payments for future services — Secured creditor was ruled to have claim in priority to parents — No constructive trust existed as remedy for unjust enrichment since parents could not establish absence of juristic reason for enrichment of school and agreement made fees paid to school legally owing as long as school continued to operate.

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Becker v. Pettkus (1980), 1980 CarswellOnt 299, 1980 CarswellOnt 644, [1980] 2 S.C.R. 834, 117 D.L.R. (3d) 257, 34 N.R. 384, 8 E.T.R. 143, 19 R.F.L. (2d) 165 (S.C.C.) — considered

Canada Deposit Insurance Corp. v. Canadian Commercial Bank (1992), 5 Alta. L.R. (3d) 193, [1992] 3 S.C.R. 558, 16 C.B.R. (3d) 154, 7 B.L.R. (2d) 113, *(*sub nom. *Canada Deposit Insurance Corp. v. Canadian Commercial Bank (No. 3))* 131 A.R. 321, *(*sub nom. *Canada Deposit Insurance Corp. v. Canadian Commercial Bank (No. 3))* 25 W.A.C. 321, 1992 CarswellAlta 790, 97 D.L.R. (4th) 385, *(*sub nom. *Canada Deposit Insurance Corp. v. Canadian Commercial Bank (No. 3))* 143 N.R. 321, 1992 CarswellAlta 298 (S.C.C.) — referred to

Christian Brothers of Ireland in Canada, Re (2004), 2004 CarswellOnt 574, 69 O.R. (3d) 507, 49 C.B.R. (4th) 12 (Ont. S.C.J. [Commercial List]) — referred to

Garland v. Consumers' Gas Co. (2004), 2004 CarswellOnt 1558, 2004 CarswellOnt 1559, 2004 SCC 25, 72 O.R. (3d) 80 (note), 237 D.L.R. (4th) 385, 319 N.R. 38, 43 B.L.R. (3d) 163, 9 E.T.R. (3d) 163, 42 Alta. L. Rev. 399, 186 O.A.C. 128, [2004] 1 S.C.R. 629 (S.C.C.) — referred to

Graphicshoppe Ltd., Re (2005), 2005 CarswellOnt 7008, *(*sub nom. *Graphicshoppe Ltd. (Bankrupt), Re)* 205 O.A.C. 113, 21 E.T.R. (3d) 1, 260 D.L.R. (4th) 713, C.E.B. & P.G.R. 8178, 49 C.C.P.B. 63, 15 C.B.R. (5th) 207, 78 O.R. (3d) 401 (Ont. C.A.) — referred to

Statutes considered:

Bankruptcy and Insolvency Act, R.S.C. 1985, c. B-3
Generally — referred to

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

MOTION by interim receiver for directions about distribution of sale proceeds and determination of priorities.

***C. Campbell J.*:**

1 This motion for directions brought by the Interim Receiver appointed under the *Bankruptcy and Insolvency Act*, R.S.C. 1985, c.B-3 (the "BIA") sought guidance with respect to the rights of the Plaintiff, a secured creditor, as contrasted with those of parents who paid tuition to the Cedar Grove School (the "School"), a private institution.

2 New Solutions holds a second mortgage on the land and buildings formerly occupied by the School (which went into default, a writ of possession exercised and a sale held with proceeds now being held by the Interim Receiver.) In addition, New Solutions made a valid registration prior to default of a security interest under the *Personal Property Security Act*.

3 Various parents claim recovery of tuition funds paid either to the School or the Interim Receiver on various bases: of contract, entitlement, a constructive or implied trust, or unjust enrichment. At the conclusion of oral submissions, the Court advised the parties that since the parents were not represented by counsel, the Court might seek the assistance of knowledgeable counsel as a friend of the Court or "amicus curia," to provide submissions with respect to the position of the parents.

4 The Court is indebted to Mr. Jason Wadden and his firm Goodmans LLP for their willingness to assist and for careful and thorough advice provided to the Court. Mr. Wadden's assistance is in the finest tradition of the practising bar.

5 What gives rise to the claim of entitlement on the part of the parents is the proposal made by the Interim Receiver and accepted by all the creditors, including the parents following the appointment of BDO, the Interim Receiver, in September of 2005.

6 The accepted proposal saw the School operate during the September to December 2005 semester on the expectation that a sale would take place within that time, which would allow the School to continue.

7 Some parents had made tuition payments for the entire school year in July 2005; others made instalment payments in July and October and still others made payments on a monthly basis.

8 The Interim Receiver was unable following their appointment on September 27, 2005 to locate or account for the approximately $800,000 paid by parents to the School on account of the upcoming school year.

9 The Interim Receiver is only able to account for those funds received from parents following their appointment and proposes to apply the same in respect of the charges applicable for the actual months following their appointment in which the School actively operated.

10 As a consequence of the School's closure, certain Parents asked the Interim Receiver to recognize certain Pre-Receivership payments that they made to the School and to apply their Pre-Receivership payments to the amounts that they owe for Post-Receivership services provided. They are also asking to be reimbursed for any over-payments.

11 The parents' position was set out in a written submission by Paul Moloughny, one of the parents, which is attached to the Interim Receiver's Report, and from the speaking notes of Marion Karol on behalf of a number of parents.

12 New Solutions, whose claim is on the assets recovered from the sale of the School property, asserts that as of September 27, 2005, the School was insolvent and all monies paid by parents as of that date represent claims of unsecured creditors.

13 The then-current school year ran from September 2005 to June 2006. The Interim Receiver was of the view that the fairest way to determine when the tuition fees were "earned" was to use a straight-line allocation over the September 2005 to June 2006 school year. Accordingly, 1/10th of the total tuition payable was notionally earned each month of the school year.

14 The School charged the following fees: (i) tuition fees; (ii) a non-refundable registration fee, which was applied towards the tuition fees if the student attended the School; (iii) bussing service fees; and (iv) a security deposit that, in the normal course, was returned to Parents once the student left the School. The School offered different payment plans for the payment of the fees, each of which resulted in the Parents paying all or a part of tuition fees before the services were actually rendered. [1] All fees paid by the Parents that were not earned by the School are referred to as "Advanced Payments."

15 The Interim Receiver continued the School's operations until the end of December 2005. The Interim Receiver operated the School in the hope that a going-concern sale of the School could be concluded. Although the Interim Receiver received offers to purchase the School as a going-concern, the best offer, which was accepted, required the School to be closed at the end of December 2005. Since no services were provided in the Second Semester, the amount of tuition actually "earned" by the School was only 4/10ths [2] of the total tuition for the 2005-2006 school year.

16 After the Interim Receiver was appointed, some of the Parents made payments to the Interim Receiver. The monies paid to the Interim Receiver were for services that were to be provided in the future, including services that would have been provided in the Second Semester. For example, parent Paul Moloughey (who had two children enrolled at the school), paid $5,548 to the Interim Receiver on or about October 15, 2005, in accordance with the applicable payment plan, bringing his total payments to $12,596. As the tuition fees attributable to the First Semester amounted to only $7,257.60, $5,338.40 can be said to be attributable to the the Second Semester.

17 The Interim Receiver reported in the Third Report that it used the amounts that it received from the Parents to fund the School's current operating costs, and that it had initially proposed to refund the monies it received from

Parents to the extent that the amounts paid were in excess of the amounts attributable to the First Semester. The Interim Receiver deposited the monies it received from the Parents into an estate bank account. However, the Interim Receiver also reported that it did not segregate the amounts that might be attributable to the Second Semester because (i) all of the funds were required for the School's ongoing day-to-day operations during the First Semester; and (ii) it was unable to allocate the payments to any particular period given the state of the School's records. Accordingly, all of the funds that the Interim Receiver received were deposited into the bank account and used to fund the School's day-to-day operations.

18 The Interim Receiver now seeks the Court's advice and direction with respect to the distribution of the proceeds of the sale of the School's assets. The Parents argue that they are entitled to a refund of the Advance Payments that are attributable to the Second Semester since those services were never provided. New Solutions, the next ranking secured creditor, argues in response that all Advance Payments represent unsecured claims and are subordinate to its secured interests.

19 The main issue raised on the motion is whether or not monies paid in advance or as a down payment for services to be provided in the future have priority over secured creditors when the contemplated services are not provided.

20 I am satisfied, based on the submissions of counsel for New Solutions and the Interim Receiver and the opinion of Mr. Wadden that the claim of the Secured Creditor New Solutions must prevail.

21 The Goodmans opinion considered (i) whether the Advance Payments are subject to an express trust, and if so, has the express trust survived; (ii) whether the Parents have an arguable claim for a constructive or resulting trust; (iii) whether the Parents have an arguable claim for equitable subordination; (iv) whether marshalling may apply; and (v) whether the Parents have an arguable set-off claim. There does not appear to be any other basis on which the parents could potentially claim priority.

Express Trust

22 I agree with the conclusion that there does not appear to be any basis on which the Parents could arguably claim that the Advance Payments are protected by an express trust. If the Advance Payments were impressed with an express trust that has survived into the proceeds held by the Interim Receiver, the Parents would be entitled to such funds in priority to New Solutions' secured interest.

23 The Admission Agreement signed by the Parents provides acknowledgement that the Parents must pay the full amount of the tuition fees regardless of whether or not the services are actually provided to the student. Since the tuition fees are owed regardless of whether services are actually provided, it does not appear arguable that an express trust was created or even intended. The additional rights contained in the Admission Agreement are all dependent on full payment of all academic fees.

24 Mr. Wadden also considered the issue of whether or not there are any custom or general rules that advance or down payments on account of services to be provided in the future are presumed to be held in trust. He reviewed case law from Canada, the United Kingdom, Australia, New Zealand and the U.S., and was unable to find any cases in which an advance or down payment made on account of future services was presumed to be held in trust simply because the payment was made on account of services to be rendered in the future.

25 Even if the Parents had an arguable claim for an express trust, it appears that the Parents' claim could not survive the fact that the School's bank accounts were empty at the time of the appointment of the Interim Receiver. The Advance Payments that were made prior to the appointment of the Interim Receiver were co-mingled with the School's other funds, all of which had been depleted at the time of the Interim Receiver's appointment. Because the priority contest is between a putative trust claimant and a secured creditor, as opposed to competing trust claims, the "lowest intermediate balance rule" applies. [3] Given that the School's bank accounts were nil at the time the Interim Receiver was appointed, the Parents cannot recover any Advance Payments that were made prior to the appointment of the Interim Receiver.

26 It appears that the Advance Payments were used to fund the School's operating expenses (or were improperly taken), and were not used to improve the School's property or to buy other capital assets. Accordingly, it appears that the Parents would have difficultly establishing an arguable tracing argument, which would be required to substantiate an express trust claim.

Constructive Trust

27 I am also satisfied that it also appears that the Parents do not have an arguable claim that they are entitled to a constructive trust over the proceeds of the School's assets.[4] Constructive trusts are generally imposed in two situations: (i) as a remedy to unjust enrichment; and (ii) as a remedy to certain wrongs. Neither of those circumstances applies here.

28 To prove unjust enrichment against either the School or New Solutions, the Parents would have to prove that (i) the School or New Solutions received a benefit; (ii) the Parents suffered a corresponding deprivation; and (iii) there is no juristic reason for the enrichment.[5]

29 I accept that the parents are deprived of monies they paid to the School. It is not clear on the material before the Court that the monies paid benefited New Solutions. Both the Secured Creditor and the parents were of the view that as of September 2005 there was a brighter prospect for the future than turned out to be the case.

30 However, it does not appear that the Parents have a reasonable prospect of establishing an absence of a juristic reason for the enrichment.[6] In this case, there is a juristic reason for both the School's enrichment and New Solution's enrichment. In the case of the School, there is a contract between the Parents and the School making the amounts paid to the School (and by extension, the Interim Receiver) legally owing so long as the School continued to operate. New Solutions forbore from instituting a petition into bankruptcy and immediate recovery of its property interest in the School's assets. I am satisfied that the parents do not have an arguable claim for unjust enrichment.

Equitable Subordination

31 Mr. Wadden also considered whether or not the doctrine of equitable subordination could potentially apply in this case. Under that doctrine, a claim of a secured creditor may be subordinated to a lower ranking claim. The Supreme Court of Canada has articulated the test for equitable subordination as follows:[7]

1. the creditor must have engaged in some type of "inequitable" conduct;

2. the misconduct must have resulted in injury to the creditors or conferred an unfair advantage on the claimant; and

3. equitable subordination of the claim must not be inconsistent with the provisions of a statute.

32 The application of the doctrine of equitable subordination is limited and questionable at best in Canadian law. I am satisfied that there is no evidence in the material before the Court that there is any wrongful conduct whatsoever on the part of New Solutions, a necessary condition for any application of the doctrine.

Conclusion

33 I am not aware of any decision in which in the absence of misconduct by a secured creditor, its perfected interest under the *Personal Property Security Act (Ontario)* could be subordinated to an otherwise unsecured claim.

34 Special counsel also considered potential grounds for relief titled marshalling and set-off. I am satisfied that neither of these grounds is applicable in this case. In my view there has been a thorough review of all possible remedies. For the above reasons, I am satisfied that the parents do not have a claim in priority to New Solutions and so order.

35 I am grateful for the assistance of all counsel, as their advice was consistent. In particular, the effort of Mr. Wadden to pursue any possible remedy that might be said to assist them will hopefully provide some solace for the position that the Court has determined is appropriate.

36 In the circumstances of this somewhat novel situation I do not think this an appropriate case for costs.

Order accordingly.

Footnotes

1 The payment plans offered by the School include (i) payment in full in advance; (ii) payment in three installments; and (iii) monthly payments. All payment plans required the Parents to begin making payment before the tuition fees are earned. As a result, all Parents made advance payments to some extent.

2 September to December 2005 being only 4 out of 10 months of the school year.

3 See *Graphicshoppe Ltd., Re* (2005), 78 O.R. (3d) 401 (Ont. C.A.)

4 For the purposes of this analysis, we have only considered whether the Parents have reasonable claim for a constructive trust given that the traditional bases for a resulting trust (being the failure of an express trust or the failure of a gift) do not arise in this case.

5 See *Becker v. Pettkus*, [1980] 2 S.C.R. 834 (S.C.C.)

6 Under the Canadian formulation of the test for unjust enrichment, the claimant must be able to show that there is no juristic reason for the enrichment, as opposed to the U.K. formulation in which the claimant must only establish an unjust factor: McInnes, Unjust Enrichment, Juristic reasons and Palm Tree Justice: *Garland v. Consumers' Gas Co.* [2004 CarswellOnt 1558 (S.C.C.)]; 41 C.B.L.J. 103.

7 See *Canada Deposit Insurance Corp. v. Canadian Commercial Bank* (1992), 97 D.L.R. (4th) 385 (S.C.C.); *Christian Brothers of Ireland in Canada, Re* (2004), 69 O.R. (3d) 507 (Ont. S.C.J. [Commercial List])

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2016 ONCA 662
Ontario Court of Appeal

U.S. Steel Canada Inc., Re

2016 CarswellOnt 14104, 2016 ONCA 662, 270 A.C.W.S. (3d) 471

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

In the Matter of a Proposed Plan of Compromise or Arrangement with Respect to U.S. Steel Canada Inc.

George R. Strathy C.J.O., P. Lauwers J.A., M.L. Benotto J.A.

Heard: March 17, 2016
Judgment: September 9, 2016
Docket: CA C61331

Counsel: Gordon Capern, Kristian Borg-Olivier, Denise Cooney, for Appellant, United Steel, Paper and Forestry, Rubber, Manufacturing, Energy, Allied Industrial and Service Workers International Union
Andrew Hatnay, Barbara Walancik, for Non-union retirees and active employees of U.S. Steel Canada Inc.
Tamryn Jacobson, for Her Majesty the Queen in Right of Ontario and Superintendent of Financial Services (Ontario)
Michael E. Barrack, Jeff Galway, John Mather, for Respondent, United States Steel Corporation
Sharon Kour, for U.S. Steel Canada Inc.

Subject: Civil Practice and Procedure; Insolvency

Headnote

Bankruptcy and insolvency --- Companies' Creditors Arrangement Act — General principles — Jurisdiction — Court

Company was in Companies' Creditors Arrangement Act (CCAA) protection — Former employees of company claimed its American parent company ran company into insolvency to further its own interests — Former employees sought to have CCAA judge apply American legal doctrine of "equitable subordination" to subordinate parent company's claims to former employee's claims — CCAA judge held that he had no jurisdiction to apply doctrine of equitable subordination — Union appealed — Appeal dismissed — Nowhere in words of CCAA was there authority, express or implied, to apply doctrine of equitable subordination, nor did it fall within scheme of statute, which focused on implementation of plan of arrangement or compromise — Words "may make any order it considers appropriate in circumstances" in s. 11 of CCAA must be read as "may in furtherance of purposes of act make any order it considers appropriate in circumstances" — There was no support for concept that phrase "any order" in s. 11 provided at-large equitable jurisdiction to reorder priorities or to grant remedies as between creditors — Section 6(8) of CCAA effectively subordinates "equity claims", as defined, to claims of all other creditors — "Equitable subordination" is form of equitable relief to subordinate claim of creditor who has engaged in inequitable conduct, such claim was not "equity claim" as defined — There was no "gap" in legislative scheme to be filled by equitable subordination through exercise of discretion, common law, court's inherent jurisdiction or by equitable principles.

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APPEAL by union of judgment finding that court had no jurisdiction to apply American doctrine of equitable subordination.

***George R. Strathy C.J.O.*:**

1 U.S. Steel Canada Inc. ("USSC") is in *CCAA* [1] protection. Its former employees claim that its American parent, United States Steel Corporation ("USS"), ran the company into insolvency to further its own interests. An issue arose in the court below as to whether the *CCAA* judge could apply an American legal doctrine called "equitable subordination" to subordinate USS's claims to the appellant's claims.

2 The *CCAA* judge held he had no jurisdiction to do so. For reasons different than the ones he gave, I agree, and would dismiss the appeal.

FACTUAL BACKGROUND

3 USS is one of the largest steel producers in North America. In 2007, it acquired Stelco, which was in *CCAA* protection at the time, and changed its name to USSC.

4 Seven years later, on September 16, 2014, USSC was again granted *CCAA* protection by order of the Superior Court of Justice (Commercial List).

5 The *CCAA* judge made a Claims Process Order on November 13, 2014, establishing a procedure for filing, reviewing and resolving creditors' claims against USSC.

6 The order set out a separate procedure for resolving claims of approximately $2.2 billion by USS against USSC. Most of the claims arose from USS's acquisition and reorganization of Stelco and from advances of working capital. Those claims were to be determined by the court, rather than by the Monitor.

7 USS filed its proofs of claims. The Monitor recommended they be approved and USS moved for court approval of the claims.

8 Notices of Objection were filed by four parties: (a) the Province of Ontario and the Superintendent of Financial Services in his capacity as administrator of the Pension Benefits Guarantee Fund; (b) the United Steelworkers, Locals 8782 and 1005; (c) Representative Counsel to the Non-USW Active Salaried Employees and Non-USW Salaried Retirees; and (d) Robert Milbourne, a former president of Stelco, and his wife, Sharon Milbourne, both of whom are beneficiaries of a pension agreement with USSC.

9 These objections overlapped to some extent. The *CCAA* judge had to develop a procedure to address the objections. He had to decide whether they should be dealt with within the *CCAA* process, outside it, or not at all.

10 The Province made two allegations. The first was that loans by USS to USSC should be characterized as shareholders' equity, because of the circumstances in which they were made. They should therefore be subordinated to all other claims pursuant to s. 6(8) of the *CCAA* [2] (the "Debt/Equity Objection"). Second, the Province argued that the security for the loans should be invalidated pursuant to provincial and federal fraudulent assignment and fraudulent preference legislation (the "Security Objection"). USS disputed both allegations, but was content to have the issues determined under the Claims Process Order.

11 The Union made objections similar to the Province's, but it added a third based on oppression and breach of fiduciary duty arising out of USS's conduct in relation to the Canadian plants, pensioners, pension plan members and beneficiaries (the "Conduct Objections").

12 The *CCAA* judge described the Conduct Objections as allegations that USS caused USSC to underperform, thereby requiring it to incur significant debt and to be unable to meet its pension obligations. The Union sought, among other things, an order subordinating the USS claims in whole or in part to its claims.

13 The Milbournes' objections were based on USS's alleged conduct and relied primarily on the doctrine of equitable subordination. They asked that the USS claims be dismissed entirely or subordinated to the claims of the other unsecured creditors.

14 The *CCAA* judge scheduled a motion to establish a litigation plan for USS's motion for approval of its claims against USSC. The parties agreed that the Security Objection and the Debt/Equity Objection could be determined pursuant to the Claims Process Order and within the *CCAA* proceedings. [3]

15 The primary disagreement concerned the procedure and timing for the determination of the other objections. The Union argued that the Conduct Objections should be resolved as part of the Claims Process Order and that an evidentiary

record was required to do so. USS and USSC took the position that the Conduct Objections should be litigated outside the *CCAA* claims process.

16 The *CCAA* judge found that some of the claims of the Union and the Milbournes could be approached as third party claims against USS for oppression for the purpose of s. 241 of the *Canada Business Corporations Act*, R.S.C. 1985, c. C-44, and for breach of fiduciary duty. He found that neither the Claims Process Order nor the *CCAA* contemplated that such claims would be addressed by or would be relevant to a plan of arrangement or compromise under the *CCAA*. The third party claims fell outside the claims process unless specifically incorporated into the restructuring plan as approved by the parties or otherwise ordered.

17 The *CCAA*, he said at para. 65, "is directed towards the creation, approval and implementation of a plan of arrangement or compromise proposed between a debtor company and its secured and unsecured creditors". It did not contemplate incorporation of inter-creditor claims into any plan of arrangement or compromise or into the voting process in respect of any proposed plan.

18 He concluded, at para. 84, that under s. 11 the court had authority to order the remaining claims of the Union and the Milbournes, except the claim for equitable subordination, to be "determined by a process within the *CCAA* proceedings, other than the process contemplated by the Claims Process Order, if the Court is of the opinion that, on balance, such action is likely to further the remedial purpose of the *CCAA*." He held that those claims could be determined within the *CCAA* proceedings, rather than in a separate action in the Superior Court, but not under the Claims Process Order. He noted that the court retained jurisdiction to order that the claims be continued outside the *CCAA* if it was determined that pursuing them within the process would no longer further the remedial process of the *CCAA*.

19 He held, however, that he had no jurisdiction under the *CCAA* to apply the doctrine of equitable subordination. Before turning to his reasons, I will explain the doctrine of equitable subordination.

EQUITABLE SUBORDINATION

20 Equitable subordination was developed as an equitable remedy in American insolvency law to subordinate a creditor's claim based on its inequitable conduct. The principles were articulated in *Mobile Steel Co., Re*, 563 F.2d 692 (U.S. C.A. 5th Cir. 1977), which set out a three-part test:

a. the claimant must have engaged in some type of inequitable conduct;

b. the misconduct must have resulted in injury to creditors of the bankrupt or conferred an unfair advantage on the claimant; and

c. equitable subordination of the claim must not be inconsistent with the provisions of the bankruptcy statute.

21 Paragraph 105(a) of the U.S. *Bankruptcy Code* authorizes bankruptcy courts to use equitable principles to alter the provisions of Title 11 or to prevent an abuse of process. One year after *Mobile Steel*, the *Code* was amended to give legislative effect to equitable subordination: *Bankruptcy Reform Act*, 11 U.S.C. §510(c)(1).

22 The Supreme Court of Canada considered the doctrine on two occasions. In both, the court found it unnecessary to determine whether equitable subordination should be applied, because the underlying facts did not meet the test: *Canada Deposit Insurance Corp. v. Canadian Commercial Bank*, [1992] 3 S.C.R. 558 (S.C.C.), at p. 609; and *Indalex Ltd., Re*, 2013 SCC 6, [2013] 1 S.C.R. 271 (S.C.C.), at para. 77. This court also found it unnecessary to decide the issue in *Olympia & York Developments Ltd. v. Royal Trust Co.* (1993), 14 O.R. (3d) 1 (Ont. C.A.).

23 The availability of the doctrine has been considered in various Canadian superior courts at the trial level, in various contexts and with inconclusive results: see *General Chemical Canada Ltd., Re*, [2006] O.J. No. 3087 (Ont. S.C.J. [Commercial List]), (in the context of the *Bankruptcy and Insolvency Act*, R.S.C., 1985, c. B-3); *Christian Brothers of*

Ireland in Canada, Re (2004), 69 O.R. (3d) 507 (Ont. S.C.J. [Commercial List]), (in the context of the *Winding-up and Restructuring Act*, R.S.C. 1985, C. W-11, as amended).

24 In *AEVO Co. v. D & A Macleod Co.* (1991), 4 O.R. (3d) 368 (Ont. Bktcy.), Chadwick J. rejected the application of equitable subordination in Canadian law, observing, at p. 372, that to introduce the doctrine would create chaos and would lead to challenges to security agreements based on the conduct of the secured creditor. In *I. Waxman & Sons Ltd., Re* (2008), 89 O.R. (3d) 427 (Ont. S.C.J. [Commercial List]), Pepall J. queried, at para. 33, whether statutory priorities should be upset by a doctrine "divorced from its legal home". This observation was followed, however, with the comment that "a vibrant legal system must be responsive to new developments in the law and the need for reform. Jurisprudence from other jurisdictions often provides the impetus or basis for much needed legal developments."

25 On the other hand, the Newfoundland and Labrador Supreme Court (Trial Division) applied the doctrine in a bankruptcy case in *Lloyd's Non-Marine Underwriters v. J.J. Lacey Insurance Ltd.*, 2009 NLTD 148, 291 Nfld. & P.E.I.R. 149 (N.L. T.D.).

26 The Supreme Court of Canada's silence on the issue of equitable subordination in *CDIC* and *Indalex* cannot be taken, as the *CCAA* judge appears to have thought, as an outright rejection of the doctrine. In my view, the Supreme Court simply left the issue for another day.

27 It is unnecessary to decide that issue in order to resolve this appeal. The only issue is whether the *CCAA* judge was right in deciding that he had no jurisdiction to grant equitable subordination under the *CCAA*, assuming the remedy is available in Canadian law.

SUBMISSIONS AND ANALYSIS

A. PROCEDURAL OBJECTION

28 The appellant's first submission is procedural. It claims that it was unnecessary for the *CCAA* judge to determine whether he had jurisdiction to grant equitable subordination. The Union essentially says it was blindsided. It says it made no submissions on the doctrine of equitable subordination and the *CCAA* judge did not indicate that he was going to address the issue in the context of the scheduling motion. It was inappropriate and unnecessary for the court to shut the door on a novel and controversial remedy without a full factual record.

29 The respondent acknowledges that equitable subordination was not a central issue in the oral submissions before the *CCAA* judge, but points out that it was raised in some of the factums and memoranda filed before and after the hearing. The *CCAA* judge was required to determine what conduct-based inter-creditor claims would be litigated, either under the Claims Process Order or under the *CCAA*. He was entitled to determine whether he had jurisdiction to grant equitable subordination within the *CCAA*.

30 I do not accept the appellant's submission. The issue of equitable subordination was plainly before the *CCAA* judge in submissions made before and after the hearing. The Milbournes' factum made extensive submissions on equitable subordination and argued that it, along with fiduciary duty and oppression, were "live issues which should be the subject matter of a robust evidentiary record and subject to a fair and thorough due process in this court". The Union's factum suggested that some of USS's unsecured claim could be subordinated to the claims of other creditors "on account of a breach of fiduciary duty, a finding of oppression, *or otherwise*." USSC's factum argued that the Union's claim for equitable subordination should be rejected and that suitable remedies were available outside the Claims Process. In supplementary written submissions, the Union argued, in response to USSC's submissions, that the determination of the issue of equitable subordination should await an evidentiary record.

31 Moreover, the issue before the *CCAA* judge was not simply scheduling. The motion sought directions on the extent and nature of production and discovery with respect to the various objections. The Union argued that the objections had to be resolved before there could be approval of a plan of restructuring, a sale process or a distribution to creditors.

The allegations that USS's claims should be re-characterized, invalidated, disallowed or subordinated had to be resolved and the *CCAA* judge had to determine a process for their resolution. Some might be dealt with under the Claims Process Order and some might be dealt with outside that Order but nevertheless in the *CCAA* proceedings. Some might not be dealt with under the *CCAA* at all.

32 The *CCAA* judge was plainly aware that a determination of the inter-creditor claims could have implications for the approval of any subsequent reorganization, sale of the business or credit bid. It was appropriate for him to consider whether the court had jurisdiction to address those claims and, if so, how and when.

33 An evidentiary record was unnecessary. The *CCAA* judge was not deciding whether equitable subordination applied on the facts of this case. The issue was whether he had jurisdiction to grant equitable subordination under the *CCAA*.

34 I turn now to the question whether the *CCAA* judge correctly held that he had no jurisdiction under the *CCAA* to order equitable subordination of USS's claims.

B. JURISDICTION TO ORDER EQUITABLE SUBORDINATION

35 I will begin by summarizing the *CCAA* judge's reasons on this issue. I will then set out the submissions of the parties, identify the standard of review, describe the methodology I will use and apply that methodology to the legislation.

(1) The CCAA judge's reasons

36 The *CCAA* judge noted that although the *CCAA* gives authority to re-characterize debt as equity and to invalidate a preference or assignment, there is no express provision conferring jurisdiction to grant equitable subordination. He was of the view that any jurisdiction to do so would have to be found in s. 11, which provides that "the court ... may, subject to the restrictions set out in this Act ... make any order that it considers appropriate in the circumstances."

37 He observed that there is no Canadian case law supporting that authority and, when given the occasion to confirm the existence of equitable subordination on two occasions, the Supreme Court of Canada had declined to do so: *Canada Deposit Insurance Corp.*; and *Indalex*. He suggested that one might infer from this that the Supreme Court had rejected the principle of equitable subordination.

38 He found, however, that to the extent the issue remained open, the *CCAA* evidenced an intention to exclude equitable subordination. When Parliament amended the legislation in 2009, it gave authority under s. 6(8) to subordinate debt as being in substance equity, but it did not enact any provision to subordinate a claim based on the conduct of the creditor. Nor had it drafted s. 36.1, which permitted the court to invalidate preferences and assignments, broadly enough to permit the court to make an order for equitable subordination. These provisions, he said, were "restrictions set out in this Act", limiting the court's broad discretion under s. 11. Parliament's failure to include equitable subordination in the remedies introduced in 2009 must be taken as indicative of an intention to exclude the operation of the doctrine under the *CCAA*. This, he said, was a policy decision the court must respect.

(2) The submissions of the parties

39 The appellant submits the *CCAA* judge had jurisdiction to grant equitable subordination pursuant to s. 11 of the *CCAA* in the absence of express "restrictions" on that jurisdiction. He erred in implying restrictions based on Parliament's failure to amend the legislation.

40 The respondent submits that Canadian courts have all the tools they need to assess, review and, where necessary, subordinate or invalidate creditors' claims in a manner consistent with the underlying legislation, without the need for equitable subordination. Some of these tools are the result of the 2009 amendments to the *BIA* and the *CCAA*. Parliament might have expanded those amendments to incorporate equitable subordination or some other conduct-based remedy, but declined to do so. The court should not invoke a controversial doctrine that Parliament declined to adopt when it had the opportunity to do so.

(3) The standard of review

41 The parties agree that the applicable standard of review is correctness: *Housen v. Nikolaisen*, 2002 SCC 33 (S.C.C.), at para. 8; and *ATB Financial v. Metcalfe & Mansfield Alternative Investments II Corp.*, 2008 ONCA 587, 92 O.R. (3d) 513 (Ont. C.A.), at para. 40.

(4) Framework for analysis

42 In *Ted Leroy Trucking Ltd., Re*, 2010 SCC 60, [2010] 3 S.C.R. 379 (S.C.C.) [hereinafter Century Services], at paras. 65ff., the Supreme Court of Canada gave guidance on the approach to the scope of statutory remedies under the *CCAA*, and, if need be, under related sources of judicial authority. The court adopted the analysis proposed by Justice Georgina R. Jackson of the Court of Appeal for Saskatchewan and Professor Janis Sarra in an article entitled, "Selecting the Judicial Tool to get the Job Done: An Examination of Statutory Interpretation, Discretionary Power and Inherent Jurisdiction in Insolvency Matters" in Sarra, ed., *Annual Review of Insolvency Law, 2007* (Toronto: Thomson Carswell, 2007), at p. 41. Blair J.A. also approved of this approach in *Metcalfe & Mansfield*, at paras. 48-49.

43 Jackson and Sarra note that the *CCAA* is skeletal legislation and advocate a transparent and consistent methodology as judges define the scope of their jurisdiction under the statute. They propose that the courts should take a hierarchical view of the powers at their disposal, adopting a broad, liberal and purposive interpretation of the statute and applying the principles of statutory interpretation before turning to other tools such as the common law or the exercise of inherent jurisdiction.

44 At para. 66 of *Century Services*, the Supreme Court held that in most cases, the search for jurisdiction under the *CCAA* should be an exercise in statutory interpretation. The starting point is the "big picture" principles of statutory interpretation.

45 Driedger's modern principle is the crucial tool for construing skeletal legislation such as the *CCAA*. A court must go beyond an examination of the wording of the statute and consider the scheme of the Act, its object or the intention of the legislature and the context of the words in issue:

> Today there is only one principle or approach, namely, the words of an Act are to be read in their entire context and in their grammatical and ordinary sense harmoniously with the scheme of the Act, the object of the Act, and the intention of Parliament.

See: Jackson and Sarra, at p. 47; Elmer A. Driedger, *The Construction of Statutes*, 2d ed (Toronto: Butterworths, 1983) at p. 87, cited in *Bell ExpressVu Ltd. Partnership v. Rex*, 2002 SCC 42, [2002] 2 S.C.R. 559 (S.C.C.), at para. 26. See also *Rizzo & Rizzo Shoes Ltd., Re*, [1998] 1 S.C.R. 27 (S.C.C.), at paras. 23, 40.

46 With this in mind, I will apply the framework in *Century Services* to the search for jurisdiction. I turn first to a consideration of the purpose and scheme of the *CCAA*, before considering the language of the statute.

(5) Application of the framework

(i) The purpose of the CCAA

47 There is no dispute about the purpose of the *CCAA*. It describes itself as "An Act to facilitate compromises and arrangements between companies and their creditors". Its purpose is to avoid the devastating social and economic effects of commercial bankruptcies. It permits the debtor to continue to carry on business and allows the court to preserve the status quo while "attempts are made to find common ground amongst stakeholders for a reorganization that is fair to all": *Century Services*, at para. 77.

48 The *CCAA* has proven to be a flexible and successful tool to enable businesses to avoid bankruptcy. As Professor Sarra notes, "[i]t has been the statute of choice for debtor corporations in every major Canadian restructuring in the past quarter century, including national airlines, major steel and forestry companies, telecommunications companies, major retail chains, real estate and development groups, and the national blood delivery system": Janis P. Sarra, *Rescue! The Companies' Creditors Arrangement Act*, 2d ed. (Toronto: Carswell, 2013), at p. 1.

49 The *CCAA* achieves its goals through a summary procedure for the compromise or arrangement of creditors' claims against the company. It was described in *Stelco Inc., Re* (2005), 75 O.R. (3d) 5 (Ont. C.A.), at para. 36, as:

> a statutory framework to extend protection to a company while it holds its creditors at bay and attempts to negotiate a compromised plan of arrangement that will enable it to emerge and continue as a viable economic entity, thus benefiting society and the company in the long run, along with the company's creditors, shareholders, employees and other stakeholders.

50 The process has been effective because it is summary, it is practical, it is supervised by an independent expert monitor and it is managed in real time by an experienced commercial judge.

51 *Century Services* is a good example of how the purpose of the *CCAA* informs the exercise of the court's authority. At issue in that case were the reconciliation of another federal statute with the *CCAA* and the scope of a *CCAA* judge's discretion. At para. 70, the orders of the *CCAA* judge were considered squarely within the context of the purpose of the Act:

> The general language of the *CCAA* should not be read as being restricted by the availability of more specific orders. However, the requirements of appropriateness, good faith, and due diligence are baseline considerations that a court should always bear in mind when exercising *CCAA* authority. <u>Appropriateness under the *CCAA* is assessed by inquiring whether the order sought advances the policy objectives underlying the *CCAA*. The question is whether the order will usefully further efforts to achieve the remedial purpose of the *CCAA* — avoiding the social and economic losses resulting from liquidation of an insolvent company.</u> I would add that appropriateness extends not only to the purpose of the order, but also to the means it employs. Courts should be mindful that chances for successful reorganizations are enhanced where participants achieve common ground and all stakeholders are treated as advantageously and fairly as the circumstances permit.
>
> [emphasis added]

52 The Supreme Court concluded, at para. 75, that the order advanced the underlying purpose of the *CCAA*.

(ii) The scheme of the CCAA

53 The *CCAA* has been described as "skeletal" or "under-inclusive" legislation, (Jackson and Sarra at p. 48) which grants broad powers to the courts in general terms.

54 The Act has five parts. Part I, entitled "Compromises and Arrangements" permits the court to sanction a compromise or arrangement between a company and its secured or unsecured creditors, or both.

55 The powers of the court are found in Part II, entitled "Jurisdiction of Courts". The statute gives the court jurisdiction to receive applications, order stays, approve debtor-in-possession financing and appoint a monitor, among other things. Proceedings are commenced by an application to the Superior Court. The court generally grants an initial stay, appoints a monitor with authority to repudiate leases and other agreements and authorizes debtor in possession financing. A process is established for the identification and review of creditors' claims by the monitor and to deal with disputed claims, with the ultimate purpose of establishing classes of creditors who will vote, by class, on the compromise or arrangement.

56 One possible outcome is the preparation of a plan of arrangement. Creditors vote by class on the plan at a meeting called for that purpose. A majority by number of creditors in each class, together with two-thirds of the creditors in that class by dollar value, must approve the plan. If a class of creditors approves the plan, it is binding on all creditors within the class, subject to the court's approval of the plan. If all classes of creditors approve the plan, the court must then approve the plan as a final step.

57 Part III, entitled "General", deals with such issues as the determination of the amount of creditors' claims, classes of creditors, the duties of monitors, the disclaimer of agreements between the company and third parties and preferences and transfers at undervalue.

58 Section 19 identifies "claims" that may be dealt with in a compromise or arrangement. Those are claims provable in bankruptcy that relate to debts or liabilities, present or future, to which the *debtor company* is subject or may become subject before the compromise or arrangement is sanctioned. [4]

59 The significance of this definition is that the focus of the plan of arrangement is claims against the *debtor company* that are provable in bankruptcy. The *CCAA* judge identified this significance at para. 59 of his reasons, where he noted that s. 19(1) of the *CCAA* provides, effectively, "that a plan of compromise or arrangement may only deal with claims that relate to debts or liabilities to which a debtor company is subject at the time of commencement of proceedings under the *CCAA*". At para. 61, he noted that neither the Claims Process Order nor the *CCAA* contemplated that inter-creditor claims would be addressed by or be relevant to a plan of arrangement.

60 Section 20 sets out the method for determining the amount of the claim of any secured or unsecured creditors. In most cases, it will be the amount "determined by the court on summary application by the company or by the creditor".

61 Section 22 provides for the establishment of classes of creditors for the purpose of voting on a compromise or arrangement, based on, among other things, the nature of their claims, the nature of the security in respect of their claims and the remedies available to them in relation to their claims. Creditors may be included in the same class "if their interests or rights are sufficiently similar to give them a commonality of interest".

62 Part IV deals with Cross-Border Insolvencies. Its stated purposes are to give mechanisms to provide for the fair and efficient administration of such insolvencies, to promote cooperation with courts of other jurisdictions, to promote "the rescue of financially troubled businesses to protect investment and preserve employment" and to protect the interests of creditors, of other interested persons and of the debtor company. Part V deals with Administration.

63 The *CCAA* was amended in 2009. The amendments were the product of extensive discussion of the *BIA* and the *CCAA* in the Standing Senate Committee on Banking, Trade and Commerce. The Committee recommended amendments to the legislation, including an expanded power to review, invalidate or subordinate creditors' claims under the *CCAA*.

64 These recommendations were reflected in the 2009 amendments in two respects. First, s. 6(8) provides that a compromise or arrangement will not be approved unless it provides that all other claims are to be paid in full before an equity claim is paid.

65 This provision, coupled with the definition of "equity interest" [5] and "equity claim" [6] in s. 2(1), permits the court to determine whether a creditor's claim is in substance a share, warrant or option. This is the underpinning of the Debt/Equity Objection, an objection based on a disagreement as to the proper characterization of the disputed claims.

66 Section 22.1, also added in 2009, provides that all creditors with equity claims are to be in the same class unless the court otherwise orders, and may not, as members of that class, vote at any meeting unless the court otherwise orders.

67 Second, the 2009 amendments harmonized the rules of reviewable transactions under the *BIA* and the *CCAA*. Creditors in a *CCAA* proceeding are now entitled to invoke the provisions of the *BIA* to invalidate security granted by a debtor corporation to a creditor where a fraudulent preference or transfer at undervalue is established. Section 36.1 of the *CCAA* provides that ss. 38 and 95 to 101 of the *BIA* apply, with any required modifications, in respect of a compromise or arrangement, unless the compromise or arrangement provides otherwise.

68 USS says that the 2009 amendments reflected Parliament's decision concerning the extent of the court's jurisdiction over "reviewable transactions" in *CCAA* proceedings and the extent to which a creditor's claim can be subordinated to other claims as a result of its conduct. It says Parliament might have included jurisdiction to rearrange priorities between creditors, for example through equitable subordination, but it declined to do so.

69 The scheme of the *CCAA* focuses on the determination of the validity of claims of creditors against the company and the determination of classes of claims for the purpose of voting on a compromise or arrangement. Except as contemplated by ss. 2(1), 6(8), 22.1 and 36.1, the statute does not address either conflicts between creditors or the order of priorities of creditors. Priorities are, however, part of the background against which the plan of compromise or arrangement is negotiated.

70 There is nothing in the record before us to indicate that the issue of equitable subordination was given serious consideration at the time of the 2009 amendments or that those amendments were intended to import other remedies.

(iii) Interpreting the particular provisions before the court

71 I now turn to the words of the statute itself, considered in context and having regard to the scheme of the *CCAA*, the object of the act and the intentions of Parliament.

72 As Blair J.A. put it when deciding whether the *CCAA* granted the court the power to sanction the disputed order in *Metcalfe & Mansfield*, at para. 58, "[w]here in the words of the statute is the court clothed with authority to approve a plan incorporating a requirement for third-party releases?" The question before us is "where (if at all) in the words of the statute is the court (implicitly or explicitly) clothed with authority to make an order for equitable subordination of the USS claims?"

(a) Section 11: "The engine that drives the statutory scheme"

73 The parties focussed their arguments on whether the powers granted by s. 11 include the power to grant the remedy of equitable subordination. In order to inform the scope of s. 11, they urge us to consider the treatment of "equity" claims in s. 6(8) of the *CCAA* and the remedies available under s. 36.1.

74 In *Stelco*, at para. 36, Blair J.A. described s. 11 as "the engine that drives this broad and flexible statutory scheme". Section 11 states, in full:

> Despite anything in the *Bankruptcy and Insolvency Act* or the *Winding-up and Restructuring Act*, if an application is made under this Act in respect of a debtor company, the court, on the application of any person interested in the matter, may, subject to the restrictions set out in this Act, on notice to any other person or without notice as it may see fit, make any order that it considers appropriate in the circumstances.
>
> [Emphasis added.]

75 Prior to amendment in 2005 (S.C. 2005, c. 47, s. 128), the underlined portion above had read "subject to this Act". In *Century Services*, the Supreme Court, at paras. 67-68, interpreted this amendment as being an endorsement of the broad reading of *CCAA* jurisdiction that had been developed in the jurisprudence.

76 The jurisdiction under s. 11 has two express limitations. First, the court must find that the order is "appropriate in the circumstances". Second, even if the court considers the order appropriate in the circumstances, it must consider whether there are "restrictions set out in" the *CCAA* that preclude it.

77 As I have noted, the *CCAA* judge held that s. 11 did not confer jurisdiction to apply the doctrine of equitable subordination. The statute could have provided the authority to subordinate claims on this basis, as it did with equity claims, but it did not. He also held that the definition of "equity claim" and the option to bring proceedings under s. 36.1 were "restrictions" within the meaning of s. 11.

78 In my view, the interpretative process should start with the scope of s. 11 before the restrictions are considered in the analysis. The broad powers exercised by *CCAA* judges evolved in the jurisprudence before the concept of "restrictions" was legislated.

79 Moreover, it is inconsistent with the anatomy and history of the *CCAA* to maintain that if Parliament had intended that a *CCAA* judge would have the authority to make a certain type of order, it would have said so. The Supreme Court has made it clear that "[t]he general language of the *CCAA* should not be read as being restricted by the availability of more specific orders": *Century Services* , at para. 70.

80 What is apparent from the many creative orders that have been made, before and since the 2009 amendments, is that such orders are made squarely in furtherance of the legislature's objectives. In *Century Services*, at para. 59, the Supreme Court observed that "[j]udicial discretion must of course be exercised in furtherance of the *CCAA*'s purposes", to avoid the devastating social and economic effects of bankruptcy while an attempt is made to organize the affairs of the debtor under court supervision.

81 The words "may ... make any order it considers appropriate in the circumstances" in s. 11 must, in my view, be read as "may ... *in furtherance of the purposes of this act*, make any order it considers appropriate in the circumstances."

82 There is no support for the concept that the phrase "any order" in s. 11 provides an at-large equitable jurisdiction to reorder priorities or to grant remedies as between creditors. The orders reflected in the case law have addressed the business at hand: the compromise or arrangement.

83 I turn to the second limit on the court's jurisdiction under s. 11, the "restrictions set out in this Act". The first question is whether such restrictions must be express or can be implied.

84 It bears noting that there are numerous express restrictions on the court's jurisdiction contained within the *CCAA* itself. Some are contained in Part II (Jurisdiction of Courts) and some are actually preceded by the heading "Restriction". In *North American Tungsten Corp. v. Global Tungsten and Powders Corp.*, 2015 BCCA 426, 81 B.C.L.R. (5th) 102 (B.C. C.A.), at para. 34, the British Columbia Court of Appeal observed that "where other provisions of the statute are intended to restrict the powers under ss. 11 and 11.02 of the statute, they do so in unequivocal terms."

85 The *CCAA* judge found that there were "restrictions set out" in the *CCAA* that prevented the court from applying equitable subordination, namely the definition of "equity claim" in s. 2(1) and the provisions of s. 36.1. Essentially, he found that Parliament could have introduced equitable subordination into the *CCAA* when it amended the legislation in 2009, but declined to do so. "The court must respect that policy decision", he said at para. 53. The respondent supports this interpretation.

86 I agree with the appellant that "equity claim" is not a restriction at all, but a definition. Together with s. 6(8), it codifies what was essentially the law before the 2009 amendments. The purpose of this involvement in the priority of claims is to remove shareholders from the process of arriving at a compromise or arrangement, absent permission of the court. It has nothing to do with any wrongdoing by the person with the equity interest. The only "restriction", if any, would be the lack of flexibility to reverse this statutory subordination, as Pepall J. pointed out in *Nelson Financial Group*

Ltd., Re, 2010 ONSC 6229, 75 B.L.R. (4th) 302 (Ont. S.C.J. [Commercial List]), at para. 34. However, this has to do only with subordination flowing from the characterization of a claim and not equitable subordination.

87 I also agree that the plain meaning of the words "subject to the restrictions *set out* in this Act" refers to express restrictions, of which there are a number.

(b) Subsection 6(8): Subordination of "equity claims"

88 In the court below, and in the appellant's submissions in this court, there was a blurring of the distinction between the separate concepts of "equity claim" and the doctrine of "equitable subordination". The *CCAA* judge's reasons referred at times to the "subordination claims" of the Union and the Milbournes as including the equitable subordination claims and the claims for oppression and breach of fiduciary duty.

89 As explained earlier, s. 6(8) of the *CCAA* effectively subordinates "equity claims", as defined, to the claims of all other creditors. No compromise or arrangement can be approved unless it provides for other claims to be paid, in full, before equity claims are paid.

90 With the exception of environmental claims, ss. 6(8) and 22.1 are the only provisions of the *CCAA* to deal expressly with priorities between creditors.[7] There is a clear rationale for these provisions. In E. Patrick Shea*, BIA, CCAA & WEPPA: A Guide to the New Bankruptcy & Insolvency Regime* (Markham: LexisNexis Group, 2009), at p. 89, the author explains that "[t]he intention of these amendments is to remove the shareholder/creditor from the reorganization process, unless the court orders that they have a seat at the table."

91 "Equitable subordination", on the other hand, refers to the doctrine at issue here: a form of equitable relief to subordinate the claim of a creditor who has engaged in inequitable conduct. Such a claim is not an "equity claim", as defined. If it were, it would be subordinated without the need for intervention by the court.

92 Pepall J. dealt with these different principles and distinguished them clearly in *I. Waxman & Sons Ltd.*, a Commercial List decision that predated the 2009 amendments. There, a trustee in bankruptcy brought a motion for advice and directions as to whether a judgment creditor's claim should be allowed. Other creditors argued that his claim was rooted in equity and was not a debt claim. In the alternative, they argued that even if it was a debt claim, it should be subordinated to their claims pursuant to the doctrine of equitable subordination.

93 Pepall J. addressed the argument that the judgment creditor's claim was an equity claim under the heading "Characterization" (paras. 18-26), because the issue was whether his claim was properly characterized as one of equity or debt, with the attendant priority consequences. Next she considered whether, even though she had found that the claim was a debt claim, it should be subordinated pursuant to the doctrine of equitable subordination (paras. 27-35). She noted, at para. 27, that "[a]s its name suggests, the basis for development of the doctrine is the equitable jurisdiction of the court". She held that even if it applied in Canada, which was not established, there was no evidence on which to apply it in that case.

94 By contrast, the *CCAA* judge in this case disposed of these issues under one heading, "The Authority of the Court to Adjudicate Claims for Debt Re-Characterization and for Equitable Subordination", at paras. 38-53. He found, at para. 51, that the absence of any provision in the *CCAA* that would permit the application of equitable subordination was indicative of an intention to exclude the operation of the doctrine.

95 The *CCAA* judge appears to have treated equitable subordination as akin to equity claims as defined in s. 2(1), the subordination of equity claims in s. 6(8) and the remedies under s. 36.1. He found that because equitable subordination is not mentioned in the context of these remedies, Parliament must have intended to exclude it.

96 The distinction between these terms undermines the argument that equitable subordination does not exist because it was not included as part of the definition of (or together with the subordination of) equity claims. Equity claims are

subordinated in order to keep shareholders away from the table while the claims of other creditors are being sorted out. Even prior to being explicitly subordinated by statute in 2009, they generally ranked lower than general creditors: *Sino-Forest Corp., Re*, 2012 ONCA 816, 114 O.R. (3d) 304 (Ont. C.A.), at para. 30. The purpose of the 2009 amendments appears to have been to confirm and clarify the law: see The Report of the Standing Senate Committee on Banking, Trade and Commerce, *Debtors and Creditors Sharing the Burden: A Review of the Bankruptcy and Insolvency Act and the Companies' Creditors Arrangement Act* (Ottawa, November 2003), at p. 158-59.

(c) Section 36.1: Preferences and Assignments

97 Section 36.1, which was part of the 2009 amendments, incorporates by reference provisions of the *BIA* permitting the court to invalidate prior fraudulent preferences or fraudulent assignments.

> 36.1 (1) Sections 38 and 95 to 101 of the *Bankruptcy and Insolvency Act* apply, with any modifications that the circumstances require, in respect of a compromise or arrangement unless the compromise or arrangement provides otherwise.

98 The respondent argues that the inclusion of these express provisions implies that no other form of equitable remedy was contemplated. Its argument is that, had Parliament wished to invalidate or subordinate claims of creditors who had engaged in inequitable conduct in relation to other creditors, it could have expressly included that remedy.

99 I would not read anything into s. 36.1, one way or the other. Nor would I regard it as a "restriction" set out in the Act within the meaning of s. 11.

(6) Summary

100 The appellant requested "a declaration that the *CCAA* contains no restrictions within the meaning of s. 11 on the court's ability to apply the doctrine of equitable subordination." In my view, this is the wrong inquiry and this is why I reach the same result as the *CCAA* judge, but for different reasons.

101 I would not grant the relief sought because, applying the principles of statutory interpretation, nowhere in the words of the *CCAA* is there authority, express or implied, to apply the doctrine of equitable subordination. Nor does it fall within the scheme of the statute, which focuses on the implementation of a plan of arrangement or compromise. The *CCAA* does not legislate a scheme of priorities or distribution, because these are to be worked out in each plan of compromise or arrangement. The subordination of "equity claims" is directed towards a specific group, shareholders, or those with similar claims. It also has a specific function, consistent with the purpose of the *CCAA*: to facilitate the arrangement or compromise without shareholders' involvement.

102 The success of the *CCAA* in fulfilling its statutory purpose has been in large measure due to the ability of judges to fashion creative solutions, for which there is no express authority, through the exercise of their jurisdiction under s. 11. As Blair J.A. noted in *Metcalfe and Mansfield*, however, the court's powers are not limitless. They are shaped by the purpose and scheme of the *CCAA*. The appellant has not identified how equitable subordination would further the remedial purpose of the *CCAA*.

103 At this stage of the analysis, I am mindful of the Supreme Court's observation in *Century Services* that in most cases the court's jurisdiction in *CCAA* matters will be found through statutory interpretation. I am also mindful of its observation in *Indalex*, at para. 82, that courts should not use an equitable remedy to do what they wish Parliament had done through legislation. In my view, there is no "gap" in the legislative scheme to be filled by equitable subordination through the exercise of discretion, the common law, the court's inherent jurisdiction or by equitable principles.

104 There is no provision in the *CCAA* equivalent to s. 183 of the *BIA* or §105(a) of the U.S. *Bankruptcy Code*. Section 183 invests the bankruptcy court with "such jurisdiction at law and in equity" as will enable it to exercise its bankruptcy jurisdiction. This is significant, because if equitable subordination is to become a part of Canadian law, it would appear

that the *BIA* gives the bankruptcy court explicit jurisdiction as a court of equity to ground such a remedy and a legislative purpose that is more relevant to the potential reordering of priorities.

CONCLUSION

105 For these reasons, I would dismiss the appeal. I would order that counsel may make written submissions as to costs, not to exceed five pages in length, excluding costs outlines. I would assume counsel can agree on a timetable for delivery of all costs submissions within 30 days of the release of these reasons.

***P. Lauwers J.A.*:**

I agree

***M.L. Benotto J.A.*:**

I agree

Appeal dismissed.

Footnotes

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

2 6(8) No compromise or arrangement that provides for the payment of an equity claim is to be sanctioned by the court unless it provides that all claims that are not equity claims are to be paid in full before the equity claim is to be paid.

3 In a subsequent ruling, *U.S. Steel Canada Inc., Re*, 2016 ONSC 569 (Ont. S.C.J.), the *CCAA* judge dismissed the Debt/Equity objection, finding that approximately $2 billion of USSC's unsecured claims and $73 million in secured claims were properly characterized as debt rather than equity. He also dismissed the objection that approximately $118 million in secured claims should be invalidated due to lack of consideration or as a fraudulent preference.

4 *CCAA*, s. 2(1): "*claim* means any indebtedness, liability or obligation of any kind that would be a claim provable within the meaning of section 2 of the *Bankruptcy and Insolvency Act*." Section 121 of the *BIA* states that claims provable in bankruptcy are those to which the bankrupt is subject: "121(1) All debts and liabilities, present or future, to which the bankrupt is subject on the day on which the bankrupt becomes bankrupt or to which the bankrupt may become subject before the bankrupt's discharge by reason of any obligation incurred before the day on which the bankrupt becomes bankrupt shall be deemed to be claims provable in proceedings under this Act."

5 "*Equity interest* means (a) in the case of a company other than an income trust, a share in the company — or a warrant or option or another right to acquire a share in the company — other than one that is derived from a convertible debt, and (b) in the case of an income trust, a unit in the income trust — or a warrant or option or another right to acquire a unit in the income trust — other than one that is derived from a convertible debt."

6 "*Equity claim* means a claim that is in respect of an equity interest, including a claim for, among others, (a) a dividend or similar payment, (b) a return of capital, (c) a redemption or retraction obligation, (d) a monetary loss resulting from the ownership, purchase or sale of an equity interest or from the rescission, or, in Quebec, the annulment, of a purchase or sale of an equity interest, or (e) contribution or indemnity in respect of a claim referred to in any of paragraphs (a) to (d)."

7 Subsection 11.8(8) gives the federal and provincial Crowns priorities for environmental claims against the debtor.

End of Document

43

2013 BCSC 480
British Columbia Supreme Court

Pacific Shores Resort & Spa Ltd., Re

2013 CarswellBC 725, 2013 BCSC 480, [2013] B.C.W.L.D. 3719, [2013] B.C.W.L.D. 3872, [2013] B.C.W.L.D. 3874, 14 B.L.R. (5th) 53, 1 P.P.S.A.C. (4th) 131, 226 A.C.W.S. (3d) 934

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

In The Matter of The Business Corporations Act, S.B.C. 2002, c. 57

In The Matter of Pacific Shores Resort & Spa Ltd., Westerlea Sales Consulting Ltd., Aviawest Resorts Inc., Ocean Place Holdings Ltd., Fairfield Ventures Inc., and Parkside Project Inc., Petitioners

Fitzpatrick J.

Heard: February 13, 2013
Judgment: March 20, 2013
Docket: Vancouver S117098

Counsel: J.A. Hall, for Owners, Strata Plan VIS6830
C.D. Brousson, J. Winters (A/S), for bcIMC Construction Fund Corporation, bcIMC Specialty Fund Corporation

Subject: Insolvency; Restitution; Civil Practice and Procedure; Corporate and Commercial; Estates and Trusts; Property

Headnote

Bankruptcy and insolvency --- Priorities of claims — Unsecured claims — Priority with respect to secured creditors

Equitable relief — S Corp. accrued account receivable owing by P Inc. in respect of its commercial units for its share of utilities supplied to property development — P Inc. sought protection from creditors and interim order was granted under Companies' Creditors Arrangement Act (CCAA) — P Inc.'s CCAA proceedings were unsuccessful and order was granted placing it into receivership — After receivership, amounts owing to S Corp. for utilities continued to climb and billings totalled $135,737.95 — bcIMC Inc. claimed first ranking security interest in net sale proceeds — S Corp. brought application to determine priorities, seeking payment of outstanding utility bills against secured creditors, on basis of unjust enrichment — Application dismissed — There was no basis upon which S Corp. could have argued that constructive trust was appropriate, as relationship between S Corp. and P Inc. was always one of unsecured creditor and debtor — S Corp. was not entitled to assert priority on basis of what it could or should have done — Violence would be done to commercial law if established priority regimes were altered or circumvented on ad hoc basis and based on individual notions of fairness.

Restitution and unjust enrichment --- General principles — Requirements for unjust enrichment — No juristic reason for enrichment

Bankruptcy priority regime — S Corp. accrued account receivable owing by P Inc. in respect of its commercial units for its share of utilities supplied to property development — P Inc. sought protection from creditors and interim order was granted under Companies' Creditors Arrangement Act (CCAA) — P Inc.'s CCAA proceedings were unsuccessful and order was granted placing it into receivership — After receivership, amounts owing to S Corp. for utilities continued to climb and billings totalled $135,737.95 — bcIMC Inc. claimed first ranking security interest in net sale proceeds — S Corp. brought application to determine priorities, seeking payment of outstanding utility bills against secured creditors, on basis of unjust enrichment — Application dismissed — S Corp. failed to show that this case did not fall within established category of juristic reason, namely "disposition of law", such that claim was defeated by s. 116 of Strata Property Act — It was evident that this unfortunate situation arose from S Inc.'s failure to take steps to include these amounts in its operating budgets so that they might have been characterized as "strata fees" — There was no basis on which S Corp. could have argued constructive trust was appropriate.

Restitution and unjust enrichment --- Benefits conferred under ineffective transactions — Miscellaneous

Bankruptcy priority regime — S Corp. accrued account receivable owing by P Inc. in respect of its commercial units for its share of utilities supplied to property development — P Inc. sought protection from creditors and interim order was granted under Companies' Creditors Arrangement Act (CCAA) — P Inc.'s CCAA proceedings were unsuccessful and order was granted placing it into receivership — After receivership, amounts owing to S Corp. for utilities continued to climb and billings totalled $135,737.95 — bcIMC Inc. claimed first ranking security interest in net sale proceeds — S Corp. brought application to determine priorities, seeking payment of outstanding utility bills against secured creditors, on basis of unjust enrichment — Application dismissed — S Corp. failed to show that this case did not fall within established category of juristic reason, namely "disposition of law", such that claim was defeated by s. 116 of Strata Property Act — It was evident that this unfortunate situation arose from S Inc.'s failure to take steps to include these amounts in its operating budgets so that they might have been characterized as "strata fees" — There was no basis on which S Corp. could have argued constructive trust was appropriate.

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KBA Canada Inc. v. 3S Printers Inc. (2012), 2012 BCSC 1078, 2012 CarswellBC 2563, 93 C.B.R. (5th) 263 (B.C. S.C.) — followed

Luscar Ltd. v. Pembina Resources Ltd. (1994), 24 Alta. L.R. (3d) 305, *(*sub nom. *Luscar Ltd and Norcen v. Pembina Resources Ltd.)* 162 A.R. 35, 83 W.A.C. 35, [1995] 2 W.W.R. 153, 1994 CarswellAlta 251 (Alta. C.A.) — considered

Mack v. Canada (Attorney General) (2002), 217 D.L.R. (4th) 583, 2002 CarswellOnt 2927, 96 C.R.R. (2d) 254, 165 O.A.C. 17, 24 Imm. L.R. (3d) 1, 60 O.R. (3d) 737, 60 O.R. (3d) 756 (Ont. C.A.) — considered

Pacific National Investments Ltd. v. Victoria (City) (2004), 34 B.C.L.R. (4th) 1, 327 N.R. 100, [2004] 3 S.C.R. 575, 206 B.C.A.C. 99, 338 W.A.C. 99, 42 C.L.R. (3d) 76, [2005] 3 W.W.R. 1, 3 M.P.L.R. (4th) 1, 2004 SCC 75, 2004 CarswellBC 2673, 2004 CarswellBC 2674, 245 D.L.R. (4th) 211 (S.C.C.) — considered

Statutes considered:

Bankruptcy and Insolvency Act, R.S.C. 1985, c. B-3
Generally — referred to

s. 245(1)(b) — referred to

Companies' Creditors Arrangement Act, R.S.C. 1985, c. C-36
Generally — referred to

s. 8(b) — referred to

s. 11.4 [en. 1997, c. 12, s. 124] — referred to

Land Title Act, R.S.B.C. 1996, c. 250
Generally — referred to

Personal Property Security Act, R.S.B.C. 1996, c. 359
Generally — referred to

s. 20(b)(i) — considered

Registry Act, R.S.O. 1990, c. R.20
Generally — referred to

Strata Property Act, S.B.C. 1998, c. 43
Generally — referred to

s. 1(1) "common expenses" — considered

s. 1(1) "common expenses" (b) — considered

s. 91 — considered

s. 92 — considered

s. 97 — referred to

s. 98 — considered

s. 99 — considered

s. 103(3) — referred to

s. 116 — considered

s. 116(1)(a) — considered

s. 116(2) — considered

s. 116(4) — considered

s. 116(5) — considered

s. 116(6) — considered

Rules considered:

Supreme Court Civil Rules, B.C. Reg. 168/2009
App. B, s. 2(2)(b) — referred to

Regulations considered:

Strata Property Act, S.B.C. 1998, c. 43
Strata Property Regulation, B.C. Reg. 43/2000

Generally — referred to

s. 6.7(1)(d) — considered

s. 6.7(2) — considered

s. 6.7(3) — considered

s. 6.7(4) — considered

APPLICATION by unsecured creditor for payment of outstanding utility bills on basis of unjust enrichment.

***Fitzpatrick J.*:**

I. Introduction

1 This insolvency proceeding involved, in part, a multi-use development located in Victoria, British Columbia, which was constructed by Fairfield Project Limited Partnership (the "LP") in 2009. The petitioner Fairfield Ventures Inc. ("Ventures") is the general partner of the LP, and the petitioner Parkside Project Inc. ("Project") holds certain lands in trust for Ventures. I will refer to all these corporations collectively as "Parkside".

2 The development is comprised of residential strata lots, and commercial and recreational spaces, defined as commercial strata lots. The development also includes common property.

3 In the ordinary course, new owners bought fractional interests in the residential strata units and established control of the strata corporation. However, certain residential and commercial strata units in the development remained with the developer, Parkside. One of the commercial strata lots initially retained by Parkside contained recreational facilities, including an indoor pool.

4 Parkside, through Ventures and Project, sought protection from its creditors on October 24, 2011, and an Interim Order was granted on that date pursuant to the *Companies' Creditors Arrangement Act*, R.S.C. 1985, c. C-36 ("*CCAA*").

5 For reasons that are not entirely clear, from March 2011, the strata corporation accrued an account receivable owing by Parkside in respect of its commercial units for its share of certain utilities supplied to the development. These amounts were billed or invoiced to Parkside on a regular basis. As of the date of the *CCAA* filing, Parkside owed the strata corporation approximately $64,125.

6 Even after the *CCAA* filing, a portion of the utility billings incurred by the strata corporation continued to be allocated and billed to Parkside, again without Parkside making any payments. The *CCAA* proceedings were, in relation to Parkside, ultimately unsuccessful. An order was granted on March 23, 2012 placing Parkside into receivership. However, the amounts owing to the strata corporation for utilities supplied after that date continued to climb even after the receivership of Parkside. From the time of the *CCAA* filing until late 2012 during the receivership proceedings, further utility billings were accrued and payable by Parkside in the amount of approximately $71,600.

7 Parkside's commercial strata units were sold pursuant to a vesting order granted on January 28, 2013. The net sale proceeds are being held pending a determination of priority issues. At the present time, the amounts owing by Parkside to the strata corporation total $135,737.95 for utilities from March 2011 to September 2012. bcIMC Construction Fund Corporation and bcIMC Specialty Fund Corporation (collectively, "bcIMC") claim a first ranking security interest in the net sale proceeds and it is anticipated that they will suffer a substantial shortfall in the recovery of their loans owing by Parkside.

8 The strata corporation is entitled to assert priority for strata fees billed to Parkside as against secured creditors, such as bcIMC, pursuant to the *Strata Property Act*, S.B.C. 1998, c. 43 (the "*Act*"). But the utility amounts referred to above were never billed by the strata corporation as "strata fees", as they could have been. Therefore, the strata corporation has no basis upon which to assert priority for these utility bills under the *Act* as against Parkside's interest in the commercial strata units.

9 The strata corporation now takes the position that it is entitled to be paid the outstanding utility bills, even against secured creditors such as bcIMC, on the basis of unjust enrichment.

II. Background

A. Statutory scheme

10 The relevant provisions of the *Act* are as follows:

> **Definitions and interpretation**
>
> **1** (1) In this Act:
>
> . . .
>
> **"common expenses"** means expenses
>
> > (a) relating to the common property and common assets of the strata corporation, or
> >
> > (b) required to meet any other purpose or obligation of the strata corporation;

. . .

Strata corporation responsible for common expenses

91 The strata corporation is responsible for the common expenses of the strata corporation.

Operating fund and contingency reserve fund

92 To meet its expenses the strata corporation must establish, and the owners must contribute, by means of strata fees, to

(a) an operating fund for common expenses that usually occur either once a year or more often than once a year, and

(b) a contingency reserve fund for common expenses that usually occur less often than once a year or that do not usually occur.

. . .

Unapproved expenditures

98 (1) If a proposed expenditure has not been put forward for approval in the budget or at an annual or special general meeting, the strata corporation may only make the expenditure in accordance with this section.

(2) Subject to subsection (3), the expenditure may be made out of the operating fund if the expenditure, together with all other unapproved expenditures, whether of the same type or not, that were made under this subsection in the same fiscal year, is

(a) less than the amount set out in the bylaws, or

(b) if the bylaws are silent as to the amount, less than $2000 or 5% of the total contribution to the operating fund for the current year, whichever is less.

(3) The expenditure may be made out of the operating fund or contingency reserve fund if there are reasonable grounds to believe that an immediate expenditure is necessary to ensure safety or prevent significant loss or damage, whether physical or otherwise.

(4) A bylaw setting out an amount for the purposes of subsection (2)(a) may set out further conditions for, or limitations on, any expenditures under that provision.

(5) Any expenditure under subsection (3) must not exceed the minimum amount needed to ensure safety or prevent significant loss or damage.

(6) The strata corporation must inform owners as soon as feasible about any expenditure made under subsection (3).

Calculating strata fees

99 (1) Subject to section 100, owners must contribute to the strata corporation their strata lots' shares of the total contributions budgeted for the operating fund and contingency reserve fund by means of strata fees calculated in accordance with this section and the regulations.

(2) Subject to the regulations, the strata fees for a strata lot's share of the contribution to the operating fund and contingency reserve fund are calculated as follows:

$$\frac{\text{unit entitlement of strata lot}}{\text{total unit entitlement of all strata lots}} \times \text{total contribution}$$

. . .

Certificate of Lien

116 (1) The strata corporation may register a lien against an owner's strata lot by registering in the land title office a Certificate of Lien in the prescribed form if the owner fails to pay the strata corporation any of the following with respect to that strata lot:

(a) strata fees;

. . .

(2) The strata corporation may register a lien against any strata lot, but only one strata lot, owned by an owner as owner developer, by registering in the land title office a Certificate of Lien in the prescribed form if the owner developer fails to pay an amount payable to the strata corporation under section 14 (4) or (5), 17 (b) or 20 (3).

. . .

(4) On registration the certificate creates a lien against the owner's strata lot in favour of the strata corporation for the amount owing.

(5) The strata corporation's lien ranks in priority to every other lien or registered charge except

(a) to the extent that the strata corporation's lien is for a strata lot's share of a judgment against the strata corporation,

(b) if the other lien or charge is in favour of the Crown and is not a mortgage of land, or

(c) if the other lien or charge is made under the *Builders Lien Act*.

(6) On receiving the amount owing, the strata corporation must within one week remove the lien by registering in the land title office an Acknowledgment of Payment in the prescribed form.

B. The Utilities Payment Scheme Adopted by the Strata Corporation

11 There is no dispute on this application concerning the procedures and protections that the strata corporation might have taken and obtained in respect of the portion of the utility bills that Parkside was obligated to pay over the years 2011-2012.

12 The development was designed so that the strata corporation receives only one bill from certain utility service providers, namely BC Hydro and Fortis BC. Accordingly, bills are forwarded to the strata corporation for hydro and gas service to the entire development. BC Hydro and Fortis BC do not direct bills to individual strata lot owners or to Parkside as an owner of certain commercial strata units. This is unlike the procedures in many developments, where utility bills are forwarded to each individual strata owner.

13 It is therefore common ground that the utilities costs for hydro and gas were a "common expense", as this term is defined under s. 1(1)(b) of the *Act*, and that the strata corporation was responsible for those expenses pursuant to s. 91 of the *Act*.

14 Section 92 of the *Act* provides that the strata corporation must establish, and the owners must contribute to, by way of strata fees, an operating fund for "common expenses". "Strata fees" are not defined by the *Act*.

15 The *Act* contemplates that the strata corporation will establish an operating budget, which is approved at the annual general meeting: s. 97. Once an operating budget is approved, the strata corporation must, with limited exceptions, pay expenditures in accordance with the approved budget: s. 98. Also, owners must contribute their share of the budgeted amounts "by means of strata fees" in accordance with certain calculations based on unit entitlement: s. 99. These calculated amounts would also, of course, include the monthly amounts as is typically seen in strata developments and contributions to the expense of maintaining common property and assets (see definition of "common expenses", s. 1(1)(a)).

16 The original operating budget was prepared by Parkside, as the developer, for the 2009/2010 fiscal year. Thereafter, PacWest Resort Strata Management Inc. ("PacWest"), through its principals Susan and Lawrence Pearson, was the strata manager. It set up the later strata operating budgets and managed and administered the 2010/2011 and 2011/2012 fiscal year budgets until approximately August 2012 when PacWest ceased to be the manager because it was no longer licensed. Under those later budgets, utility costs for residential units were treated as "common expenses" and were included in the strata operating budgets and the calculation of strata fees for individual residential strata lots, all as contemplated by the *Act*. Joint utility costs as between the residential and commercial units were also included in these calculations, presumably relating to common areas.

17 For unexplained reasons, however, PacWest excluded from the strata operating budgets the utility amounts for hydro and gas which the strata corporation was responsible to pay and which were allocable to the commercial strata lots owned by Parkside. Rather, Parkside, as a commercial strata lot owner, was invoiced by the strata corporation for its share of the single utility bills. Since one of these commercial strata lots included the swimming pool, one can appreciate that Parkside's share of the utility costs were substantial in relation to the other strata lots, whether residential or commercial. It appears that, in accordance with this practice of invoicing by the strata corporation, Parkside paid the strata corporation for its share of these utility bills up to early 2011.

18 There is no issue on this application as to whether the amounts claimed by the strata corporation are the correct amounts that were allocable to Parkside for the utilities.

19 It is well taken that it was open to the strata corporation to have included such amounts in its annual operating budgets. If so, the strata corporation could have required Parkside to pay its share of the utility fees relating to Parkside's commercial units as "strata fees" under s. 99 of the *Act*. If these amounts had remained unpaid under such a scheme, the strata corporation would have had priority for these further amounts pursuant to the lien registered by it under s. 116 of the *Act* on July 11, 2012 against Parkside's commercial strata lots. The strata corporation did accrue certain strata fees which were payable by Parkside and it was entitled to priority under the lien filed for those amounts; no issue arises with respect to these amounts. Since the utilities expenses for the commercial strata lots were excluded from the strata operating budget, however, no lien arises under the *Act* for these further amounts upon which the strata corporation can assert priority as against bcIMC.

20 Despite having invoiced Parkside for these amounts, and regardless of whether payment was received from Parkside, the strata corporation was required to pay the hydro and gas bills. If it had not done so, BC Hydro and Fortis BC would have disconnected the services and terminated the provision of these utilities to the entire development.

21 There is an issue as to who is to blame for this state of affairs. David Shrive, a member of the original strata council and a current council member, says that he relied on the guidance and experience of PacWest with respect to budget matters and that he expected that PacWest would have brought to the strata council's attention any matter requiring its consideration. He says that at no time did PacWest discuss with the strata council the matter of Parkside paying the utility bills.

22 Mr. Shrive states that the strata council knew nothing of the "issue" concerning these payments until the summer of 2012.

23 Despite Mr. Shrive's evidence, it is difficult to conclude that the strata council was unaware of outstanding amounts owing by Parkside to the strata corporation over these last two years. Parkside's insolvency and the *CCAA* proceedings were well known to the strata corporation. In fact, by the date of the *CCAA* Interim Order in October 2011, some of the owners in the development had retained counsel and were appearing on applications. The Interim Order also provided that, in the usual fashion, the petitioners, including Ventures and Project, were required to serve their creditors with notice of the proceedings. The Monitor also maintained the usual website for public access to the court materials, as provided in the Interim Order.

24 The *CCAA* Interim Order also provided in paragraph 8(b) that Parkside was entitled to pay expenses reasonably incurred by them in carrying on their business, including obligations for services supplied to them after the date of the Order. There is no evidence that the strata corporation took any steps to obtain payment from Parkside after that date beyond forwarding the invoice for October to December 2011 (presumably sometime in early January 2012), as it had done in the past.

25 Various unit owners were also represented by counsel on the receivership application in March 2012 which led to the appointment of the Receiver. In addition, as part of its duties, the Receiver was required to forward notice of its appointment to all creditors of Parkside, pursuant to s. 245(1)(b) of the *Bankruptcy and Insolvency Act*, R.S.C. 1985, c. B-3 (the "*BIA*"). Moreover, the Receiver's First Report to the court dated May 2, 2012 indicates that the Receiver was having ongoing discussions with certain residential owners' associations, particularly in relation to finding a new manager for the development.

26 Mr. Shrive did not state that the strata corporation was unaware of these proceedings over the last 15 months. Nor did he give any indication in his evidence of the strata council's level of knowledge as to the fact that these amounts were being paid by the strata corporation, billed to Parkside, and that the receivable from Parkside continued to accrue from early 2011. In my view, it would be a very unlikely scenario for the strata corporation to be entirely oblivious of the ongoing status of Parkside and the amounts they owed, since the strata corporation was required to prepare a "financial statement" for the owners' consideration at the annual general meetings in the fall of both 2011 and 2012: *Act*, s. 103(3). The requirements for such a financial statement are set out in the *Strata Property Regulation*, B.C. Reg. 43/2000 (the "*Regulation*"):

> **Financial statement requirements**
>
> **6.7** (1) For the purposes of section 103(3) of the Act, the financial statement must contain the following information for the fiscal year to which the financial statement relates as of a day that is within the 2 month period before the date of the annual general meeting:
>
> > (a) the opening balance in the operating fund and the current balance;
> >
> > (b) the opening balance in the contingency reserve fund and the current balance;
> >
> > (c) the details of the strata corporation's income from all sources, except special levies;
> >
> > (d) the details of expenditures out of the operating fund, including details of any unapproved expenditures under section 98 of the Act;
> >
> > (e) the details of expenditures out of the contingency reserve fund, including details of any unapproved expenditures under section 98 of the Act;
> >
> > (f) income and expenditures, if any, by special levy under section 108 of the Act.

> (2) Within 8 weeks after the end of its fiscal year, the strata corporation must prepare a financial statement updated to the end of the fiscal year.
>
> (3) For the purpose of distribution with notice of the annual general meeting, a strata corporation may provide, by bylaw, that the financial information required under subsection (1) (c) to (e) be provided in a summary form.
>
> (4) Despite a bylaw under subsection (3), the strata corporation must place before the annual general meeting a financial statement that complies with subsection (1).
>
> . . .
>
> [Emphasis added.]

27 In that event, it would have been evident from the financial documentation presented at the annual general meetings what amounts were paid by the strata corporation for the utilities for the commercial units, which were not approved by the strata operating budgets and which had not been paid for by Parkside. In other words, the strata corporation's balance sheet would have shown the amounts outstanding.

28 Mr. Shrive gave evidence that the strata corporation obtained legal advice on the "issue" regarding the payments made by it in the summer of 2012, around the time the s. 116 lien was registered. However, the strata corporation received a disconnection notice from BC Hydro in April 2012, which presumably arose because Parkside failed to pay the amounts invoiced to it for its share of previous hydro bills.

29 I conclude from Mr. Shrive's evidence — and more particularly from what he does not comment on — that the strata council was not oblivious to the amounts owed by Parkside. It was only in the summer of 2012, however, that the strata corporation fully appreciated the reality that the failure to include those amounts in its operating budgets deprived it of the right to assert a lien for those amounts under s. 116 of the *Act* since they were not "strata fees".

III. Discussion

30 The strata corporation asserts that it is open to this Court to grant equitable relief based on the doctrine of unjust enrichment, even in the face of the priority regime dictated by the *Act*.

31 bcIMC disputes that proposition. It contends that the *Act* is a "complete code" for the determination of priorities. Alternatively, it says that equitable relief is not appropriate in the circumstances in any event.

A. Is Equitable Relief Available in the Face of the Priority Regime under the Act?

32 The application of equitable principles in the context of a statutory priority regime inevitably gives rise to the suggestion that the fundamental purpose of the legislation will be undermined if equity is wielded to defeat statutory priorities. After all, commercial law rests on the bedrock principles of certainty and predictability. Mr. Justice Kelleher recently commented on the importance of these principles in *KBA Canada Inc. v. 3S Printers Inc.*, 2012 BCSC 1078 (B.C. S.C.):

> [43] The importance of certainty and predictability was underlined by the Supreme Court in *Royal Bank of Canada v. Sparrow Electric Corp.*, [1997] 1 S.C.R. 411, where Mr. Justice Gonthier said in a dissenting opinion, at para. 21:
>
>> More recently, provincial legislatures have moved to protect secured creditors generally through the enactment of personal property security legislation...these statutory regimes have been implemented to increase certainty and predictability in secured transactions through the creation of a coherent system of priorities...the benefits of such certainty in commercial transactions on basic economic principles, are intended to accrue to the health of the economy in general.

33 As such, courts have indeed held that introducing equitable principles into such a priority regime can have the effect of defeating the priority scheme. In the context of the priority scheme under the *Personal Property Security Act*, R.S.B.C. 1996, c. 359 (the "*PPSA*"), Master Hyslop, as she then was, in *Bankruptcy of Canadian Auto Lease Corp., Re*, 2006 BCSC 849 (B.C. S.C.) at para. 26, quoted with approval the comments of Mr. Justice Killeen in *Canadian Imperial Bank of Commerce v. Melnitzer (Trustee of)*, [1993] O.J. No. 3021 (Ont. Bktcy.)) at para. 138:

> ... the drafters of the PPSA did not intend to have its perfection-of-interests system overridden or emasculated by an endless serious of ad hoc rulings in individualized settings. Respect must be maintained for the perfection system no matter how harsh its application may appear to be in a given isolated case.

34 Nevertheless, it is apparent that courts have considered that, in appropriate circumstances, equitable principles may be applied even though they have the effect of altering what would otherwise have been the ordering of priorities under a statute.

35 In *Central Guaranty Trust Co. v. Dixdale Mortgage Investment Corp.* (1994), 24 O.R. (3d) 506 (Ont. C.A.), the court considered whether the provisions of the statute alone (the Ontario *Registry Act*) were dispositive of the claim for unjust enrichment. In that case, a mortgage had been discharged in error by the mortgagee. The mortgagee claimed that it should recover its debt from the sale proceeds as against a later mortgagee that had obviously benefited from the discharge. At pp. 515-516, Laskin J.A. held that the statute alone was not determinative:

> If the provisions of the Act alone are considered then Dixdale's position is unanswerable. Registration of the discharge gives Dixdale priority under the statute. But, in my opinion, the statute alone is not dispositive of this appeal. In an appropriate case a court may give effect to the principle of unjust enrichment despite the terms of a statute. ...
>
> ...[*Deglman v. Guaranty Trust Co. of Canada*, [1954] S.C.R. 725] reflects the wider principle that, in a proper case, a court may grant restitutionary relief although the application of a statute would otherwise preclude recovery.
>
> I agree with the following statement in Maddaugh and McCamus, *The Law of Restitution*, *supra*, at pp. 313-14:
>
>> In each case, it is submitted, the court should weigh the objective of fulfilment of the purpose of the legislation against the common law policy of preventing unjust enrichment.
>
> Lord Goff and G. Jones make the same point in their text, *The Law of Restitution*, 3rd ed. (1986), at p. 48:
>
>> Occasionally a statute will prohibit any claim whatsoever. More frequently the courts will have to decide whether the recognition of the claim will indirectly frustrate the policy of a particular statute or common law rule.
>
> Central Guaranty's claim of unjust enrichment is not one that the Act expressly prohibits. ...At the level of principle the issue is whether recognizing Central Guaranty's claim undermines the purpose of the statutory provisions in question. ...

36 That there are exceptions to the rule that a statute can provide a juristic reason for an enrichment, as adopted in *Dixdale Mortgage Investment Corp.*, was also acknowledged in *Mack v. Canada (Attorney General)* (2002), 60 O.R. (3d) 737 (Ont. C.A.) at paras. 42-44.

37 Furthermore, as in *Dixdale Mortgage Investment Corp.*, this Court has similarly rejected the position that no exceptions exist when dealing with land registration priorities. In *Fraser Valley Credit Union v. Siba*, 2001 BCSC 744 (B.C. S.C.), Madam Justice Smith addressed priorities under the *Land Title Act*, R.S.B.C. 1996, c. 250 (the "*LTA*"). In that case, a lender advanced funds in the expectation that it would be granted priority as against an existing mortgage.

The first mortgagee later refused to provide a priority agreement. Smith J. found that equitable principles may be applied in a Torrens system where appropriate:

> [16] Mr. Morris also argued that, as a general proposition, equitable relief is not available in a Torrens environment with respect to priorities issues regarding land title registration. I cannot accept that general proposition, which is inconsistent with the recognition in the authorities over many years that, except where third parties without notice are involved, the indefeasibility of title is subject to claims which may be made on the basis of equity and which may involve equitable forms of relief such as the declaration of constructive trusts. If the fee simple title of a registered owner may be attacked on the basis of a claim stemming from an alleged estoppel or unjust enrichment, surely the priority position of a charge holder against title may similarly be attacked.

38 Both authorities were adopted in support of the court's decision in *KBA Canada Inc.* where it was held that, in an appropriate case, the court could apply equitable principles within the context of the *PPSA* priority regime.

39 The only authority cited by bcIMC in support of its position is *Canada Trustco Mortgage Co. v. Gies*, 2001 BCSC 1016 (B.C. S.C.). In that case, the court held, at para. 7, that s. 116 of the *Act* is "exhaustive" of the strata corporation's entitlement to a lien and that NSF charges and late payment fines were not included in the amounts to be secured by the lien. It is apparent from the strata corporation's position that it concedes that s. 116 of the *Act* does not assist it in this case. Again, it relies on an equitable claim in unjust enrichment to seek a remedy against bcIMC that it would not otherwise have under the statutory regime.

40 I do not consider that the *Gies* decision supports the proposition that equitable principles may not be applied in any circumstance within the context of a priority dispute under s. 116 of the *Act*. To use the words of Laskin J.A. in *Dixdale Mortgage Investment Corp.*, there is nothing in the *Act* which expressly prohibits the application of equitable principles, including the present claim for unjust enrichment. This same approach was accepted within the context of priority regimes in respect of land under the *LTA* and personal property under the *PPSA* in *Siba* and *KBA Canada Inc.*, respectively.

41 Accordingly, I accept, as a matter of principle, that the court may consider equitable relief, such as constructive trust under the doctrine of unjust enrichment, even within the context of a statutory priority regime — which in this case is an amalgam of the *LTA* and the *Act*.

42 Whether it is appropriate to apply such a doctrine is entirely another matter, however. In the case of commercial disputes, such as this, the application of the doctrine of unjust enrichment will face substantial challenges, principally on the basis that the subject statute's provisions and the secured creditors' rights under its security represent a juristic reason for any enrichment.

B. Is the Application of the Doctrine of Unjust Enrichment Appropriate in These Circumstances?

43 The well-known three part test for unjust enrichment is found in *Garland v. Consumers' Gas Co.*, 2004 SCC 25 (S.C.C.) at para. 30, as follows: (1) an enrichment of the defendant; (2) a corresponding deprivation of the plaintiff; and (3) an absence of juristic reason for the enrichment.

44 Before considering the elements of the test, it is useful to consider how our Court of Appeal has highlighted the application of the *Garland* test in the context of commercial relationships. In *Ellingsen, Re*, 2000 BCCA 458 (B.C. C.A.), Mr. Justice Lambert stated:

> [65] ... But like most simple legal tests it must be applied thoughtfully and not mechanically, particularly with respect to whether there is a juristic reason for the enrichment which is said to have taken the enrichment out of the category of being "unjust". The juristic reason may be legal or equitable or both. But it must be measured in accordance with the principles of equity which underlie the remedies of restitution and the remedial constructive trust. So the

"injustice" of an enrichment must be measured by the standard of "good conscience" and, in a commercial case, the "good conscience" must be good commercial conscience.

[66] With respect to the requirement of "good commercial conscience", I refer to the majority judgment of four judges of this Court in *Atlas Cabinets & Furniture Ltd. v. Nat. Trust Co.* (1990), 45 B.C.L.R. (2d) 99, particularly at pp. 109-112. At p.109, in relation to the three tests for unjust enrichment set out in *Pettkus v. Becker*, this was said:

> In the context of a domestic relationship those three circumstances are likely to be simpler to apply than in the context of a commercial relationship, where the essence of the relationship is the enrichment of the participants, perhaps at the expense of each other, all in the name of fair and honest business dealing. In a domestic relationship, equality of the parties to the relationship should normally be the standard of fairness. But, in a business relationship, honest dealing, not equal dealing, should set the standard of fairness. That is not to say that the three factors enumerated in *Pettkus v. Becker* are not equally applicable in commercial cases. They were referred to and treated as applicable in the majority reasons, on this point, of Chief Justice Dickson in *Hunter v. Syncrude*, at p.471. But it is important to understand what is meant by "enrichment", by "deprivation" and by "juristic reason" in the context of a commercial relationship where ordinary and extraordinary flows of funds are part of the reality and purpose of the relationship. To my mind the key to the correct interpretation and application of the decisions of the Supreme Court of Canada on this subject to a commercial relationship is to focus on the "unjust" element of "unjust enrichment".
>
> . . .
>
> In my opinion the concept of the injustice of the enrichment as being against sound commercial conscience must continue to guide the application of the three tests in *Pettkus v. Becker* when they are applied to a commercial relationship.

[67] In my opinion that passage continues to set out the applicable principles with respect to unjust enrichment in a commercial relationship.

45 The courts have consistently taken a straightforward economic approach to the elements of enrichment and deprivation: *Garland* at para. 31. In *Pacific National Investments Ltd. v. Victoria (City)*, [2004] 3 S.C.R. 575 (S.C.C.), at 587, the Court stated:

> The existence of an enrichment to the defendant is governed by "a straightforward economic approach" (*Peter*, *supra*, at p. 990). An enrichment may "connot[e] a tangible benefit" (*Peel*, *supra*, at p. 790), or it can be relief from a "negative", such as saving the defendant from an expense he or she would otherwise have been *required* to make.
>
> [Original Emphasis.]

46 I accept that there is some basis upon which to find deprivation on the part of the strata corporation. It is owed funds from Parkside. And as a result of not being reimbursed, it has had to use its own funds to pay these obligations.

47 The facts of this case also support a finding of enrichment of Parkside in relation to the amounts owed up to the date of the *CCAA* filing in October 2011.

48 No remedial trust is necessary or warranted in respect of Parkside, however. There is clearly a contractual obligation between them and the strata corporation that would obviate the need for any such remedy: *Luscar Ltd. v. Pembina Resources Ltd.* (1994), 162 A.R. 35 (Alta. C.A.).

49 In *Caterpillar Financial Services Ltd. v. 360networks Corp.*, 2007 BCCA 14 (B.C. C.A.) at para. 60, the court noted the trial judge's consideration of *Luscar Ltd.* in the circumstances of that case. In turn, the court cited *Ellingsen* and stated that "the existence of a contractual relationship between the plaintiff and the defendant may preclude the imposition of

a constructive trust": para. 61. In this regard, the court adopted a "general principle" that unsecured creditors should not be allowed to "jump the queue" by means of imposing a constructive trust:

> [61] ... The general principle is stated by David M. Paciocco in "The Remedial Constructive Trust: A Principled Basis for Priorities and over Creditors", (1989) 68 Canadian Bar Rev. 315 at 341-42:
>
> > There is widespread agreement that a party who has accepted the role of a general creditor should be denied proprietary relief. The decision in *Sinclair v. Brougham* is often used to make the point. There the depositors of the bank entered into their transactions with the expectations that they would be unsecured creditors of the bank. Allowing them to trace therefore gave them proprietary protection which was never expected. Only an out of court settlement with the other general creditors of the bank and the condition imposed by the court that the depositors recognize the claims of the shareholders prevented this from producing an unwarranted priority. It has therefore been suggested that:
> >
> > > As a general principle, ... people who willingly choose to become unsecured creditors of an eventual bankrupt ought not to be given priority over other unsecured creditors through the extended use of the constructive trust remedy.
> >
> > There are two kinds of case where a claimant can be considered, every bit as much as the general creditors can, to have accepted the risk of the defendant's insolvency: where there are contractual dealings between the plaintiff and defendant which anticipate that the plaintiff will assume the status of a general creditor; and where the plaintiff's claim rests on a *quantum meruit* or *quantum valebat* basis in situations where there has been no reasonable expectation by the plaintiff of acquiring a proprietary interest.

50 The strata corporation argues that bcIMC has been enriched by reason of the non-payment of the pre-*CCAA* amounts, but I do not see that there is a necessary implication in that regard. The monies Parkside saved in that respect may well have been spent on a number of matters and not necessarily on expenses that could be said to have maintained, preserved or even enhanced the value of Parkside's assets over which bcIMC held security. In a very general sense, it may be true that the nonpayment allowed Parkside to "preserve" its assets, as alleged, although such an argument could be advanced by any unsecured creditor of Parkside.

51 The fallacy of imposing such a remedy at the time of the *CCAA* filing is apparent by looking at the situation as if Parkside had gone into bankruptcy at that time. There is no doubt that had that happened, the strata corporation would have been considered an unsecured creditor of Parkside under the *BIA* and bcIMC would have realized on its security in the ordinary course without regard to these amounts.

52 With respect to the amounts accrued post-*CCAA* filing, the strata corporation contends that bcIMC has been enriched because it now enjoys an enhanced priority position in respect of these utility fees. In *Siba* at para. 51, the court stated that there is "no reason in principle why the [unjust enrichment] doctrine should not apply where the benefit in question is an enhanced priority position".

53 Whether the enrichment analysis supports the relief sought in respect of the pre- and post-*CCAA* amounts, the crux of this matter clearly concerns whether there is a juristic reason for any enrichment of Parkside and/or bcIMC.

54 The Court in *Garland* discussed the more nuanced two-stage analysis for determining whether there is a juristic reason for the enrichment, particularly within the context of valid legislation which allows for such enrichment:

> [44] ... in my view, the proper approach to the juristic reason analysis is in two parts. First, the plaintiff must show that no juristic reason from an established category exists to deny recovery. By closing the list of categories that the plaintiff must canvass in order to show an absence of juristic reason, Smith's objection to the Canadian formulation of the test that it required proof of a negative is answered. The established categories that can constitute juristic reasons include a contract (*Pettkus*, *supra*), a disposition of law (*Pettkus*, *supra*), a donative intent (*Peter*, *supra*),

and other valid common law, equitable or statutory obligations (*Peter*, *supra*). If there is no juristic reason from an established category, then the plaintiff has made out a *prima facie* case under the juristic reason component of the analysis.

[45] The *prima facie* case is rebuttable, however, where the defendant can show that there is another reason to deny recovery. As a result, there is a *de facto* burden of proof placed on the defendant to show the reason why the enrichment should be retained. This stage of the analysis thus provides for a category of residual defence in which courts can look to all of the circumstances of the transaction in order to determine whether there is another reason to deny recovery.

[46] As part of the defendant's attempt to rebut, courts should have regard to two factors: the reasonable expectations of the parties, and public policy considerations. It may be that when these factors are considered, the court will find that a new category of juristic reason is established. In other cases, a consideration of these factors will suggest that there was a juristic reason in the particular circumstances of a case which does not give rise to a new category of juristic reason that should be applied in other factual circumstances. In a third group of cases, a consideration of these factors will yield a determination that there was no juristic reason for the enrichment. In the latter cases, recovery should be allowed. The point here is that this area is an evolving one and that further cases will add additional refinements and developments.

. . .

[49] Disposition of law is well established as a category of juristic reason. In *Rathwell*, *supra*, Dickson J. gave as examples of juristic reasons "a contract or disposition of law" (p. 455). In *Reference re Goods and Services Tax*, 1992 CanLII 69 (SCC), [1992] 2 S.C.R. 445 ("*GST Reference*"), Lamer C.J. held that a valid statute is a juristic reason barring recovery in unjust enrichment. This was affirmed in *Peter*, *supra*, at p. 1018. Most recently, in *Mack v. Canada (Attorney General)*, 2002 CanLII 45062 (ON CA), (2002), 60 O.R. (3d) 737, the Ontario Court of Appeal held that the legislation which created the Chinese head tax provided a juristic reason which prevented recovery of the head tax in unjust enrichment. In the leading Canadian text, *The Law of Restitution*, *supra*, McCamus and Maddaugh discuss the phrase "disposition of law" from *Rathwell*, *supra*, stating, at p. 46:

> ... it is perhaps self-evident that an unjust enrichment will not be established in any case where enrichment of the defendant at the plaintiff's expense is required by law.

It seems clear, then, that valid legislation can provide a juristic reason which bars recovery in restitution.

[Emphasis added.]

55 The court in *KBA Canada Inc.*, addressing the priority scheme under the *PPSA*, provided a useful review of many of the cases that have considered the application of the doctrine of unjust enrichment in the context of a statutory priority regime. I understand that the decision in *KBA Canada Inc.* is under appeal.

56 A review of *KBA Canada Inc.* and the cases discussed in that case indicates that there are usually two bases upon which the court will disregard the statutory priority provisions at the first stage of the *Garland* test and go on to consider whether the enriched party can establish a juristic reason at the second stage of that test.

57 First, where a secured party has mistakenly discharged its security and subsequent charge holders have not been prejudiced, the court may impose a constructive trust rather than allow the later charge holder, who had no expectation of gaining priority, to reap a windfall. This was the finding in *Dixdale Mortgage Investment Corp.* even where the court, in a land title context, found that the first mortgagee was negligent in discharging its mortgage. Similarly, in *KBA Canada Inc.*, Kelleher J. granted priority to a secured creditor whose *PPSA* registration had been discharged in error by another party and where subsequently registered secured creditors had not been prejudiced.

58 Second, a constructive trust may be imposed in accordance with the reasonable expectations of the parties and "good commercial conscience". In *Siba*, which dealt with land title priorities, the court, following earlier authorities, was not inclined to allow a mortgagee to receive a windfall at the expense of a later mortgagee who had advanced funds in the reasonable expectation that the first mortgagee would execute a priority agreement in its favour. Further, the majority of the court in *Ellingsen* appears to have decided that case on the basis that the bankrupt did not acquire any interest in the vehicle and that therefore, the priority of the trustee in bankruptcy under s. 20(b)(i) of the *PPSA* did not apply. Nevertheless, the court considered that a constructive trust was appropriate given the unusual circumstances under which the bankrupt had taken over possession of the truck from the seller.

59 In my view, it is clear that the strata corporation's position cannot be upheld on the reasoning found in either of these two scenarios.

60 This is not a case where the strata corporation had priority for the utility amounts but subsequently lost that priority because of a mistake, resulting in a windfall to either Parkside or bcIMC. The strata corporation was always in the position of an unsecured creditor in relation to Parkside in relation to these amounts. In other words, this situation does not arise from a *loss* of priority, but rather from a *lack* of priority.

61 In addition, I see no basis upon which the strata corporation may argue that a constructive trust is appropriate based on the reasonable expectation of the parties. Again, the relationship between the strata corporation and Parkside was always one of unsecured creditor and debtor. And with respect to bcIMC, there were no interactions between the strata corporation and bcIMC by which any expectations could arise.

62 The strata corporation points to paragraph 8(b) of the *CCAA* Interim Order. This provision provided that Parkside was "entitled to pay all expenses reasonably incurred" by them in carrying out their business after October 24, 2011, which would have included services provided, such as the utilities. However, that Order simply allowed the strata corporation to choose how to conduct its business — in particular, whether to continue to provide services on an unsecured basis or make other arrangements with Parkside in order to ensure payment after the insolvency proceedings began. In many cases, suppliers continue with the former approach even though the risk of non-payment has increased as a result of the debtor's insolvency; in other cases, COD terms are arranged; and still in others, critical suppliers will obtain court-ordered charges which protect them from the risk of nonpayment: see *CCAA*, s. 11.4.

63 Here, despite the *CCAA* proceedings, the strata corporation chose to continue with the same arrangements as before for the short five-month time frame of the *CCAA* proceedings; although I recognize that this was presumably on the basis of its or its manager's mistaken belief that it could assert priority for these amounts as "strata fees" and the difficulty in separating Parkside's obligations for these expenses from that of the entire development.

64 As stated above, the receivership order was granted on March 23, 2012. Paragraph 11 of that order provides that persons having agreements with Parkside for the supply of services are restrained from discontinuing such services as may be required by the Receiver. If the Receiver arranges for such services, then the Receiver is required to pay for such services in accordance with normal payment practices or such other practices as may be agreed upon by the supplier and the Receiver or as may be ordered by the court.

65 A significant portion of the utilities expenses paid by the strata corporation on behalf of Parkside accrued after the receivership order was granted. As such, Parkside continued to receive these services for its commercial strata units throughout the receivership proceedings, just as it did throughout the *CCAA* proceedings, without making any payments. It is not clear what discussions, if any, took place between the strata corporation and the Receiver concerning this matter beyond the possible forwarding of invoices, which apparently were ignored. Counsel for the strata corporation advises that this matter was not drawn to the attention of the Receiver until December 2012 after which time the issue was highlighted in the Receiver's later report to the court.

66 The Receiver was not represented on this application. I am advised that the Receiver has indicated to the strata corporation that it has no objection to the amount claimed; rather, the Receiver has expressed its position that the amount claimed has no priority in these proceedings. In any event, the strata corporation does not advance any claim against the Receiver for these utility amounts on this application, based on the terms of the receivership order or otherwise.

67 Returning to the case authorities addressing whether constructive trusts should be imposed in the face of statutory priority regimes, again, the court in *KBA Canada Inc.* discussed many cases which rejected such a result where no priority arose due to a failure to register security. While those cases were distinguished in *KBA Canada Inc.*, the reasoning found in those cases resonates with the facts here.

68 I begin with Chief Justice McEachern's forceful dissent in *Ellingsen*. He departed company with the majority on the effect of the arrangements between the bankrupt and the seller in terms of whether a completed sale of the truck had occurred. However, even accepting that an enrichment had resulted, he would have declined to impose a constructive trust because the seller failed to make the necessary registration under the *PPSA*:

> [48] With respect, there are good juristic reasons for this enrichment (if such it is) in the provisions of the [*PPSA*], which is intended to provide the certainty that is so necessary in the commercial law. It is probably unnecessary to point out that the assertion of a constructive trust based on unjust enrichment could become commonplace, with unfortunate commercial consequences, if such a remedy is made available upon a failure to make the necessary filings under the [*PPSA*].

69 In *Canadian Auto Lease Corp.*, the court upheld the priority provisions of the *PPSA* in favour of a trustee in bankruptcy as against a secured creditor whose registration had been improperly discharged by the bankrupt prior to the bankruptcy. This finding was in the face of the secured creditor not re-registering within the time limits mandated by the *PPSA* after that improper discharge.

70 Finally, in *Caterpillar Financial Services Ltd.*, the Court of Appeal considered a situation where the secured creditor had either not registered its security at all or had not filed a financing change statement following the debtor's name change, in accordance with and as required by the *PPSA*. The debtor, who was in *CCAA* proceedings, disallowed these claims as secured claims. The trial judge found that these were secured claims, but refused to impose a constructive trust over the sale proceeds arising from units 1, 2 and 3. On appeal, the court found it unnecessary to decide whether the finding that these were secured claims was correct: para. 53. Further, the debtor continued to argue that the imposition of a trust was inconsistent with the provisions of the *PPSA*. The court rejected that a constructive trust was appropriate to alter the creditor's position, given that there were juristic reasons for any enrichment, namely the failure to register its security:

> [62] The application of this principle to the circumstances at bar is far from straightforward. Nonetheless, it is clear that when Caterpillar entered into the leases, it intended to secure the obligations owed by 360 by retaining title to the units. Pursuant to the *PPSA*, Caterpillar could perfect its security by registration. The failure to register or perfect its security meant that, as between Caterpillar and any third parties, Caterpillar was a general creditor in respect of units 2 and 3. Although Caterpillar had negotiated with 360 to be a secured creditor, it ultimately failed to protect its status as a secured creditor under the *PPSA*. As such, Caterpillar must be taken to have accepted the risk posed by 360's eventual insolvency. In my view, Caterpillar should not be able to invoke constructive trust principles to alter its reduced creditor status.
>
> . . .
>
> [64] Under either analysis, Caterpillar appears to be employing the remedy of a constructive trust to vault its security position in respect of units 1, 2 and 3, contrary to the provisions of the *PPSA* and the general framework of the *CCAA*.

> [65] In any event, I am unable to say that the trial judge erred in his analysis. Caterpillar satisfied the initial burden of showing there was no established category of juristic reason to defeat its claim. However, the trial judge proceeded to find two other juristic reasons, one of which was Caterpillar's failure to perfect its interest and the Senior Lenders' ensuing priority over Caterpillar with respect to units 1, 2 and 3.

71 In my view, the strata corporation has failed to show that this case does not fall within an established category of juristic reason — namely a "disposition of law" — such that the claim is defeated by s. 116 of the *Act*. Further, even accepting that the strata corporation has met the burden under the first stage of the *Garland* test, it is evident that this unfortunate situation arises from the strata corporation's failure to take steps to include these amounts in its operating budgets so that they might be characterized as "strata fees". To that extent, the *ratio* of *Caterpillar Financial Services Ltd.* is apposite.

72 The strata corporation argues that there are no provisions in the *Act*, the *Regulation* or the strata bylaws which, at any time, permitted the "common expenses" to be paid other than as part of the strata fees on the basis of unit entitlement. It further says that the invoicing of Parkside for the utilities, as opposed to including such costs in the strata operating budget as common expenses, was not in accordance with the *Act*, the *Regulation* or the strata bylaws. That may be so, but I am not convinced even in that event that the imposition of a constructive trust is appropriate.

73 The other major factor is that the secured creditors of Parkside, including bcIMC, have enjoyed priority over the assets of Parkside throughout this matter arising from their properly registered security. They have conducted themselves throughout 2011 and in these proceedings on that basis and, as noted above, bcIMC will suffer a substantial loss under its loans to Parkside. I do not consider that it is appropriate or just to allow the strata corporation now to "vault" its position at this late stage in these circumstances. Nor do I consider that this results in any windfall to bcIMC. This stands as a significant juristic reason for any enrichment in that respect per *Caterpillar Financial Services Ltd.* .

74 On a final note, I should say that I have great sympathy for the strata corporation and the position it finds itself in. In most instances, as stated by counsel, a strata council is made up of volunteer owners of strata lots whose knowledge of the requirements of the *Act* may be less than ideal. Even where a strata manager is hired, as was done in this case, trust and confidence in that manager to protect the interests of the strata corporation may be misplaced. The decision was made by PacWest, as the strata corporation's manager, to continue the practice of invoicing these amounts to Parkside rather than include them in the operating budgets. This was an error but it remains an error for which the strata corporation must take responsibility. I do not consider that an *ex post facto* improvement of the strata corporation's priority status is justified to essentially insure the strata corporation against the negative effects of such advice.

75 In the second stage of the juristic reason analysis, public policy concerns may be raised and addressed. I have already mentioned the concepts of certainty and predictability which are so important to commercial law. The priority regimes under the *Act*, the *PPSA* and the *LTA* rely on these concepts so as to provide clear rules upon which commercial players can operate, particularly within the context of potential or ongoing insolvency proceedings. It is beyond question that violence would be done to commercial law if established priority regimes could be regularly altered or circumvented on an *ad hoc* basis and based on individual notions of fairness. Such an approach was especially decried by the court in *Melnitzer* and by Chief Justice McEachern in *Ellingsen*. Having said that, there will no doubt continue to be cases where the application of equitable principles is appropriate. The court in *KBA Canada Inc.* found the facts there to support the relief, but even there, the court noted that the constructive trust was imposed in what was described as "limited circumstances": para. 80.

76 No such "limited" circumstances exist here. I have decided that the strata corporation should not be entitled to assert a priority on the basis of what it could — or, more appropriately, *should* — have done. Creditors make credit decisions all the time, some of which turn out, in retrospect, to have been made in error. Imposing a constructive trust in these circumstances would only invite those types of creditors, having then had the benefit of hindsight, to ask the court to revisit and remedy those decisions. I consider that allowing such applications would detract from, rather than

enhance, the efficacy of statutory priority regimes and the public policy objectives that were intended to be achieved under those statutes.

IV. Conclusion

77 The strata corporation's application is dismissed. bcIMC is entitled to its costs of the application on Scale B.

Application dismissed.

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2013 ONSC 5431
Ontario Superior Court of Justice [Commercial List]

Hollinger Inc., Re

2013 CarswellOnt 9006, 2013 ONSC 5431, 229 A.C.W.S. (3d) 633, 90 E.T.R. (3d) 116

In the Mater of the Companies Creditors Arrangement Act, R.S.C. 1985, c. C-36, as Amended

In the Matter of a Proposed Plan of Compromise or Arrangement with Respect to Hollinger Inc., 4322525 Canada Inc. and Sugra Limited Applicants

C. Campbell J.

Heard: June 13, 2013
Judgment: June 24, 2013
Docket: 07-CL-7120

Counsel: John Finnigan, Leanne M. Williams for Applicants
David c. Moore, Karen Mitchell for Catalyst Fund General Partner I Inc.

Subject: Estates and Trusts; Insolvency; Public; Torts; Civil Practice and Procedure; Corporate and Commercial; Restitution

Headnote

Estates and trusts --- Trustees — Breach of trust — General principles

Director initially worked as advisor to creditor and was appointed to board of directors of bankrupt corporation — Director's corporation was retained by creditor to provide advice and assistance in connection with its investment in debtor corporation and act as director of bankrupt corporation and chair of its litigation committee — Creditor agreed to compensate director's corporation in accordance with customary billing practices, which included compensation for services acting as director and chair, net of any amounts director received from debtor as director's fees — Debtor entered protection under Companies' Creditors Arrangement Act — Creditor brought motion for declaration of constructive trust in respect of its additional payments to director that were not already paid by bankrupt — Motion dismissed — Work efforts of director provided benefit to debtor — Doctrine of constructive trust not applicable — Even if debtor said to receive benefit from actions of director, agreement for extra payments from creditor did not mean that debtor was unjustly enriched for not making greater payments — Debtor corporation had no equitable obligation and any expectation of possible claim beyond contractual obligation ended with bankruptcy proceedings — No assets in hands of debtor that were in breach of any equitable duty — Director was only one of many who contributed to debtor and there was no relationship between that success and settlement amounts recovered — No legitimate reason for seeking of proprietary remedy — Any claim would would be in quantum meruit not constructive trust, and trust was urged to simply to overcome claim that would not succeed in under Companies Creditors' Arrangement Act to try to gain super priority — Unjust to impose a constructive trust because the effect of doing so would interfere with priority which affected public interest — Practical uncertainty would effectively destroy flexibility and discretion that has been hallmark of CCAA process if such claims could provide super priority without agreement of all creditors.

Bankruptcy and insolvency --- Companies' Creditors Arrangement Act — Miscellaneous

Director initially worked as advisor to creditor and was appointed to board of directors of bankrupt corporation — Director's corporation was retained by creditor to provide advice and assistance in connection with its investment in debtor corporation and act as director of bankrupt corporation and chair of its litigation committee — Creditor agreed to compensate director's corporation in accordance with customary billing practices, which included compensation for services acting as director and chair, net of any amounts director received from debtor as director's fees — Debtor entered protection under Companies' Creditors Arrangement Act — Creditor brought motion for declaration of constructive trust in respect of its additional payments to director that were not already paid by bankrupt — Motion dismissed — Work efforts of director provided benefit to debtor — Doctrine of constructive trust not applicable — Even if debtor said to receive benefit from actions of director, agreement for extra payments from creditor did not mean that debtor was unjustly enriched for not making greater payments — Debtor corporation had no equitable obligation and any expectation of possible claim beyond contractual obligation ended with bankruptcy proceedings — No assets in hands of debtor that were in breach of any equitable duty — Director was only one of many who contributed to debtor and there was no relationship between that success and settlement amounts recovered — No legitimate reason for seeking of proprietary remedy — Any claim would would be in quantum meruit not constructive trust, and trust was urged to simply to overcome claim that would not succeed in under Companies Creditors' Arrangement Act to try to gain super priority — Unjust to impose a constructive trust because the effect of doing so would interfere with priority which affected public interest — Practical uncertainty would effectively destroy flexibility and discretion that has been hallmark of CCAA process if such claims could provide super priority without agreement of all creditors.

Professions and occupations --- Barristers and solicitors — Solicitor's lien — Priorities — Miscellaneous

Where solicitor acting as director of bankrupt on behalf of credior.

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Companies' Creditors Arrangement Act, R.S.C. 1985, c. C-36
Generally — referred to

MOTION by creditor for declaration of priority in funds paid to director of debtor corporation.

***C. Campbell J.*:**

1 Catalyst Fund General Partner I Inc. (Catalyst), a significant creditor of Hollinger Inc. (Hollinger), seeks a declaratory order of constructive trust in respect of its "top up" payment to Wesley Voorheis (Voorheis) in respect of his director and other services performed which have not already been paid by Hollinger in respect of such services.

2 The history of litigation involving Hollinger and events involving the Company, its directors, financial and legal advisors and its former majority owner Conrad Black (directly or indirectly) are all detailed elsewhere and need not be repeated here.

3 Suffice to say the following facts for the purposes of this motion are largely uncontested:

4 Catalyst filed a Proof of Claim dated July 11, 2008 (the Catalyst Claim), pursuant to the Claims Procedure Order dated May 21, 2008, whereby Catalyst made an unsecured claim into the estate of Hollinger in the amount of $1,988,388.10. Catalyst subsequently advised Hollinger that it was asserting the Catalyst Claim on a priority basis. The Catalyst Claim arising from an alleged pre-*CCAA* filing obligation of Hollinger.

5 The Catalyst Claim seeks recovery of funds that Catalyst paid to Voorheis & Co. LLP between May 13, 2006 and April 16, 2007. Catalyst asserts that the proceeds derived from the avenues of litigation open to Hollinger (the Litigation Assets) should be subject to a priority claim by Catalyst, notwithstanding that it is a pre-filing claim against Hollinger. Catalyst claims that Hollinger is liable for these amounts based on the following:

(a) The application of the principles of solicitors' liens;

(b) The equitable principles of unjust enrichment and constructive trust; and

(c) The principles of oppression law.

Background

6 Catalyst owns approximately eighty percent (80%) of the issued Series II Preference Shares of Hollinger and in excess of 883,000 Common Shares of Hollinger, which, at approximately $16.5 million, represents the largest arms-length shareholding position in Hollinger. Newton Glass (Glassman) is the President of Catalyst.

7 Voorheis is the Managing Partner of Voorheis & Co. LLP and the Managing Director of Voorheis & Co. Incorporated. Voorheis practiced corporate and securities law at Davies Ward, Phillips Vineberg LLP (Davies) until 1994. Since that time, Voorheis, through Voorheis & Co. LLP and Voorheis & Co. Incorporated, has acted as strategic advisor to institutional and other shareholders providing specialized strategic and other advice commonly directed at enhancing the value, performance or board oversight of Canadian public and private companies.

8 Voorheis was approached by Catalyst in 2003 to work jointly with Catalyst to enhance shareholder value at Hollinger. Initially, Catalyst proposed that VC&Co co-invest with Catalyst but such request was ultimately refused by Voorheis. In March 2004, Voorheis was retained and began acting as a strategic advisor to Catalyst in respect of its investment in Hollinger.

9 Newton Glassman of Catalyst was appointed to the Board of Directors of Hollinger (the Board) pursuant to an Order [of Mr. Justice Campbell] dated July 8, 2005. Shortly thereafter, Glassman, came to consider the Board to be dysfunctional and believed that part of the solution to the dysfunction was to have Voorheis appointed to the Board. Glassman thought that the appointment of Voorheis to the Board was in the best interest of Hollinger and all of its public stakeholders, which included Catalyst.

10 In his affidavit sworn April 30, 2008 at paragraph 29, Glassman deposed:

> I'm also of the view that the Board and management were timid and ineffective in asserting Inc.'s rights, both against Black and his associates and against Hollinger International. In retrospect, I have no doubt that I was perceived by fellow directors to be impatient and aggressive at times. I take responsibility for this ...

11 In early 2006, Glassman asked Voorheis to agree to be appointed to the Board and to take over as Chair of Hollinger's Litigation Committee from David Drinkwater. Voorheis advised Glassman that he anticipated that he would have to spend a significant amount of time to rectify the existing problems at the Hollinger Board level. Voorheis made it clear to Glassman that he would not accept an appointment to the Board if the only compensation for doing so was the normal director's fees paid by Hollinger.

12 Pursuant to the terms of the Voorheis Retainer dated May 8, 2006, Voorheis & Co was retained by Catalyst to provide advice and assistance in connection with its investment in Hollinger and, specifically, Voorheis was engaged by Catalyst to serve as director of Hollinger and Chair of Hollinger's Litigation Committee. Catalyst agreed to compensate Voorheis & Co in accordance with his customary billing practices, which included compensation for the services of Voorheis in acting as a director of Hollinger and as the Chair of the Litigation Committee, net of any amounts Voorheis received from Hollinger as director's fees.

13 For the reasons that follow I conclude that Catalyst is not entitled to super priority status in respect of the claim of Voorheis and his company.

14 I accept the admission conceded by counsel for Hollinger that the work efforts of Voorheis did provide benefit to Hollinger.

15 I also accept that as of two months before the Application of Hollinger for relief under the *Companies' Creditors Arrangements Act* (*CCAA*), the then chairman of Hollinger Stanley Beck did undertake to engage in "good faith" further discussions with Catalyst with respect to remuneration to Catalyst in respect of its contractual agreement with Voorheis which exceeded the payments by Hollinger to Voorheis as a director.

16 The intervening event of the Initial Order under the *CCAA* prevented any further discussions with Catalyst outside of the *CCCA* process.

17 Catalyst seeks recovery of these funds on a super priority basis, advancing the following reasons:

(a) this Court should apply the principles applicable to Solicitors Liens to the circumstances of this case;

(b) recent jurisprudence affirms the application of equitable principles to CCAA proceedings and this is an appropriate case to apply constructive trust and unjust enrichment principles in Catalyst's favour.

(c) alternatively, this is an appropriate case to apply oppression law principles to grant the relief sought.

18 On the material before me I conclude that Voorheis did not perform the type of service that would come under the general principle to which a solicitor's lien would apply.

19 Although Voorheis is highly qualified and experienced as a lawyer his appointment to Hollinger was as a director. I accept that he did perform additional services to Hollinger beyond that of an ordinary director but that his role was in the context of a businessman or manager not as a lawyer.

20 In my view it was Mr. Voorheis' acumen as a lawyer/businessman that was employed, not that of a solicitor in the ordinary application of the term.

21 It is to be noted that Mr. Drinkwater another director was also a lawyer, as was Mr. Glassman of Catalyst whom Mr. Voorheis replaced on the board. In addition at all times Hollinger was represented by various external counsel

22 Since business management acumen as opposed to legal services were involved, in my view there is no basis for the consideration of a solicitor's lien and the rights that might follow therefrom. Therefore, there is no basis for the awarding of relief in the nature of a Charging Order. Do these circumstances justify the application of the equitable principles of constructive trust and unjust enrichment?

23 The suggestion here is that the actions of Voorheis directly resulted in significant settlements which were approved by this Court in 2011 and 2012 and that the proceeds of those settlements are at the moment the principal assets of Hollinger and that the company would be unjustly enriched without recognizing the important contribution of Voorheis in achieving those settlements.

24 Even if one accepts that there was a benefit to Hollinger, the contributions by Voorheis, just because he had a contract with Catalyst for a higher amount than the direct fees which were the only contribution committed to by Hollinger does not result in the conclusion that Hollinger was unjustly enriched for not making a greater payment to Catalyst or Voorheis.

25 In the first place there were a number of individuals in the four year period following Voorheis' departure including the current Litigation Trustee who were equally, if not more importantly, critical to the overall success of the settlements.

26 Secondly, none of the accepted criteria for the awarding of a constructive trust are present on these facts. The limited circumstances in which a constructive trust, whether or not regarded as creating a super priority, in a *CCAA* proceeding are simply not present here in any way.

27 I accept the basic statement of law urged by Mr. Moore for Catalyst as being applicable where required for a good conscience claim:

> It thus emerges that a constructive trust may be imposed where good conscience so requires. The inquiry into good conscience is informed by the situations where constructive trusts have been recognized in the past. Equitable remedies are flexible; their award is based on what is just in all the circumstances of the case.
>
> Good conscience as a common concept unifying the various instances in which a constructive trust may be found has the disadvantage of being very general. By any concept capable of embracing the diverse circumstances in which a constructive trust may be imposed must, of necessity, be general. Particularity is found in the situations in which judges in the past have found constructive trusts. A judge faced with a claim for a constructive trust will have regard not merely to what might seem "fair" in the general sense, but to other situations where courts have found a constructive trust. The goal is but a reasoned, incremental development of the law on a case-by-case basis. [1]

28 Chief Justice McLachlin went on to add in the next paragraph:

> The situations which the judge may consider in deciding whether good conscience requires imposition of a constructive trust may be seen as falling into two general categories. The first category concerns property obtained by a wrongful act of the defendant, notably breach of fiduciary obligation or breach of duty of loyalty. The traditional English institutional trusts largely fall under but may not exhaust (at least in Canada) this category. The second category concerns situations where the defendant has not acted wrongfully in obtaining the property, but where he would be unjustly enriched to the plaintiff's detriment by being permitted to keep the property for himself. The two categories are not mutually exclusive. Often wrongful acquisition of property will be associated with unjust enrichment, and vice versa. However, either situation alone may be sufficient to justify imposition of a constructive trust.

29 In my view neither is there a wrongful act in any sense of that word on the part of Hollinger either before or after the Initial *CCAA* Order nor an unjust enrichment of Hollinger for the reasons above.

30 Much of the impetus for this motion arises from the decision in February 2013 by the Supreme Court of Canada in *Indalex Ltd.* [2] which considered the power of a Court in the context of a *CCAA* proceeding to award a constructive trust in favour of pension plan beneficiaries to whom a fiduciary duty had been breached.

31 I accept the basic premise urged by Mr. Moore that the Supreme Court recognized the potential for the remedy of constructive trust in a *CCAA* process.

32 The majority of the Supreme Court in the *Indalex Ltd.* case held that it would be inappropriate in those circumstances to award a remedy of constructive trust. I reach the same conclusion on the facts of this case.

33 As noted by majority in that decision at paragraph 239 "that imposing a constructive trust was wholly disproportionate to *Indalex Ltd.* breach of fiduciary duty"

34 At paragraph 240 on behalf of the majority on that issue it is said:

> A judicially ordered constructive trust, imposed long after the fact, is a remedy that tends to destabilize the certainty which is essential for commercial affairs and which is particularly important in financing a workout for an insolvent corporation. To impose a constructive trust in response to a breach of fiduciary duty to ensure for the plan beneficiaries some procedural protections that they in fact took advantage of in any case is an unjust response in all of the circumstances.

35 The majority who concluded both for and against the imposition of a constructive trust on the facts of *Indalex Ltd.* agreed on the conditions necessary for the awarding of such a remedy:

> (i) the defendant was under an equitable obligation in relation to the activities giving rise to the assets in his or her hands;
>
> (ii) the assets in the hands of the defendant were shown to have resulted from deemed or actual agency activities of the defendant in breach of his or her equitable obligation to the plaintiff;
>
> (iii) the plaintiff has shown a legitimate reason for seeking a proprietary remedy, either personal or related to the need to ensure that others like the defendants remain faithful to the duties; and
>
> (iv) there are no factors which would render imposition of a constructive trust in all the circumstances of the case, such as the protection of the interests of intervening creditors.

36 In my view none of the four above conditions are met on the facts of this case.

37 Firstly, there is no equitable obligation on the part of Hollinger. Any expectation of a possible claim beyond the contractual obligation of Hollinger to a director ended with the Initial Order in the *CCAA* proceeding.

38 Secondly, there is no creditable assertion of there being assets in the hands of Hollinger that are in breach of any equitable duty. Mr. Voorheis was only one of many who contributed to the success and there is no relationship between that success and the amounts recovered by way of settlement.

39 Thirdly, there is no legitimate reason for the seeking of a proprietary remedy. To the extent if at all that there could be said to be a claim it would be in quantum *meruit* not constructive trust. The imposition of a trust is urged to simply to overcome a claim that would not succeed in *CCAA* to try to gain a super priority.

40 Fourthly, in my view it would be unjust to impose a constructive trust because the effect of doing so would interfere with the priority otherwise prevailing in *CCAA* which does touch a public interest.

41 I posed the following question rhetorically to Mr. Moore: "what financer in the same business as Catalyst would be prepared to advance funds in a distressed business if it could be exposed to claims of this kind"?

42 In my view it would present a practical uncertainty that would effectively destroy the flexibility and discretion that has been the hallmark of the operation of *CCAA* if such claims as advanced here could be raised to the level to provide a super priority without the agreement of all the creditors.

43 For the above reasons, the motion of Catalyst is dismissed. If it is necessary to deal with the issue of costs, Counsel may make submissions.

Motion dismissed.

Footnotes

1 *Soulos v. Korkontzilas*, [1997] 2 S.C.R. 217 (S.C.C.) at paras 34-35.

2 *Indalex Ltd., Re*, 2013 SCC 6 (S.C.C.)

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2007 BCCA 14
British Columbia Court of Appeal

Caterpillar Financial Services Ltd. v. 360networks Corp.

2007 CarswellBC 29, 2007 BCCA 14, [2007] B.C.W.L.D. 869, [2007] B.C.W.L.D. 870, [2007] B.C.W.L.D. 871, [2007] B.C.W.L.D. 934, [2007] B.C.J. No. 22, 10 P.P.S.A.C. (3d) 311, 154 A.C.W.S. (3d) 719, 235 B.C.A.C. 95, 279 D.L.R. (4th) 701, 27 C.B.R. (5th) 115, 28 E.T.R. (3d) 186, 388 W.A.C. 95, 61 B.C.L.R. (4th) 334

Caterpillar Financial Services Limited (Appellant / Plaintiff) and 360networks corporation, 360fiber ltd., 360finance ltd., Carrier Centers (Canada) Ltd., 360Urbanlink Ltd., 360networks (cdn fiber) Ltd., 360networks services ltd., 360cayer ltée (Respondents / Defendants) and JPMorgan Chase Bank (Respondent / Intervenor)

In the Matter of the Companies' Creditors Arrangement Act, R.S.C. 1985, c. C-36; In the Matter of the Nova Scotia Companies Act, S.C., c. 81; In the Matter of the Companies Act, R.S.B.C. 1996, c. 62; In the Matter of the Canada Business Corporations Act, R.S.C. 1985, c. C-44; Caterpillar Financial Services Limited (Appellant) and 360networks inc., 360networks (holdings) ltd., 360fiber ltd., 360finance ltd., Carrier Centers (Canada) Ltd., 360 Urbanlink Ltd., 360Networks (Cdn Fiber) Ltd., 360networks services ltd., 360cayer ltée 360engineering ltd., 360pacific (canada) inc., 360networks sub inc., Threesixty Atlantic (Barbados) Inc., 360atlantic (canada) inc., 360atlantic (usa) inc., 360atlantic sales (usa) inc. (Petitioners / Respondents)

Prowse, Saunders, Kirkpatrick JJ.A.

Heard: November 17, 2006
Judgment: January 9, 2007
Docket: Vancouver CA32259, CA32286

Proceedings: affirming *Caterpillar Financial Services Ltd. v. 360networks corp.* (2004), 7 P.P.S.A.C. (3d) 1, 10 E.T.R. (3d) 59, 4 C.B.R. (5th) 4, 35 B.C.L.R. (4th) 145, 2004 BCSC 1066, 2004 CarswellBC 1835 (B.C. S.C.)

Counsel: D.A. Garner, J.A. Rost for Appellants
R.A. Millar, K. Robertson for Respondents

Subject: Insolvency; Estates and Trusts; Corporate and Commercial

Headnote

Bankruptcy and insolvency --- Proving claim — Disallowance of claim — Appeal from disallowance — Grounds

Lessee entered into leases in 1997 and 1999 with lessor — Under terms of lease, there was option at end of term of each lease agreement to purchase units, return units or agree with lessor to extend terms of lease — By February 2001, lessee was experiencing financial difficulties and sought to dispose of leased equipment — Lessee commenced proceedings under Companies' Creditors Arrangement Act ("CCAA") on June 28, 2001 — Confirmation order contained stay of all proceedings against lessee and restricted lessee to payment of obligations incurred only after Filing Date to persons who advanced or supplied goods after Filing Date — On July 24, 2002, procedural order was granted permitting lessee to file plan of arrangement — Plan was sanctioned on September 4, 2002 — Lessor submitted its proof of claim and lessee disallowed claim — Lessor appealed disallowance — Lessor was granted leave to commence separate action in which it claimed that it had constructive trust over all sale proceeds of units — Both actions were heard at same time — Trial judge concluded that lessor fell within definition of Secured Creditor as defined by plan but that full amounts owing under lease agreements were compromised by plan as deficiency claims — Lessor appealed — Appeal dismissed — In absence of specified date for calculating realizable value, trial judge considered all other reasonable sources for determining that critical date — To suggest that Plan should not be considered in making that determination was unreasonable — There was no doubt that lessor's security position was eroded between Filing Date and Plan Filing Date — Lessor had knowledge that lessee intended to sell lessor's collateral — Lessor had sufficient opportunity to demand payment prior to Filing Date — After Filing Date, lessee was prohibited by terms of initial order to make any payments to creditors holding pre-filing claim — Trial judge did not err in finding that proper date for determining realizable value of assets was July 24, 2002.

Estates and trusts --- Trusts — Constructive trust — Miscellaneous issues

Lessee entered into leases in 1997 and 1999 with lessor — By February 2001, lessee was experiencing financial difficulties and sought to dispose of leased equipment — Lessee commenced proceedings under CCAA on June 28, 2001 — On July 24, 2002, procedural order was granted permitting lessee to file plan of arrangement — Lessor submitted its proof of claim on or about September 19, 2002 and lessee disallowed claim — Lessor appealed disallowance — Lessor was granted leave to commence separate action in which it claimed that it had constructive trust over all sale proceeds of units — Both actions were heard at same time — Trial judge concluded that lessor was not entitled to declaration of constructive trust over sale proceeds from units 1, 2, and 3 but was entitled to declaration to extent of buyout amounts in respect to units 4, 7 and 8 — Lessor appealed — Appeal dismissed — Lessee conceded that lessor suffered deprivation — Trial judge found enrichment by lessee in form of reduction of its indebtedness — Trial judge found two independent juristic reasons for deprivation — Lessor's loss was product of its failure to protect its security upon receiving notice that lessee intended to sell units — Leases merely permitted lessee to sell its rights to units — Sales constituted blatant breach of leases — It was clear that when lessor entered into leases, it intended to secure obligations owed by lessee by retaining title to units — Pursuant to Personal Property Security Act ("PPSA"), lessor could perfect its security by registration — Failure to register or perfect its security meant that, as between lessor and any third parties, lessor was general creditor in respect of units 2 and 3 — Although lessor had negotiated with lessee to be secured creditor, it ultimately failed to protect its status as secured creditor under PPSA — As such, lessor must be taken to have accepted risk posed by lessee's eventual insolvency — Lessor should not be able to invoke constructive trust principles to alter its reduced creditor status — Lessor appeared to be employing remedy of constructive trust to vault its security position in respect of units 1, 2, and 3, contrary to provisions of PPSA and CCAA — Trial judge did not err in his analysis.

Bankruptcy and insolvency --- Proposal — Practice and procedure

Lessee entered into leases in 1997 and 1999 with lessor — By February 2001, lessee was experiencing financial difficulties and sought to dispose of leased equipment — Lessee commenced proceedings under CCAA on June 28, 2001 — On July 24, 2002, procedural order was granted permitting lessee to file plan of arrangement — Lessor submitted its proof of claim on or about September 19, 2002 and lessee disallowed claim — Lessor appealed disallowance — Lessor was granted leave to commence separate action in which it claimed that it had constructive trust over all sale proceeds of units — Both actions were heard at same time — Trial judge concluded that lessor was not entitled to declaration of constructive trust over sale proceeds from units 1, 2, and 3 but was entitled to declaration to extent of buyout amounts in respect to units 4, 7 and 8 — Lessor appealed — Appeal dismissed — Failure to file notice of name change did not undermine validity of registration of security interest — Failure to file notice of name change solely impacted priority — Application of s. 51(2) of PPSA resulted in lessor's perfected security interest with respect to unit being subordinate to Senior Lenders' perfected security interest.

Bankruptcy and insolvency --- Proposal — Companies' Creditors Arrangement Act — Miscellaneous issues

Lessee entered into leases in 1997 and 1999 with lessor — Under terms of lease, there was option at end of term of each lease agreement to purchase units, return units or agree with lessor to extend terms of lease — By February 2001, lessee was experiencing financial difficulties and sought to dispose of leased equipment — Lessee commenced proceedings under CCAA on June 28, 2001 — Confirmation order contained stay of all proceedings against lessee and restricted lessee to payment of obligations incurred only after Filing Date to persons who advanced or supplied goods after Filing Date — On July 24, 2002, procedural order was granted permitting lessee to file plan of arrangement — Plan was sanctioned on September 4, 2002 — Lessor submitted its proof of claim on or about September 19, 2002 and lessee disallowed claim — Lessor appealed disallowance — Lessor was granted leave to commence separate action in which it claimed that it had constructive trust over all sale proceeds of units — Both actions were heard at same time — Breach of trust relating to sale proceeds from unit 4 constituted Post-Filing Claim that was not compromised by Plan — Lessor appealed — Appeal dismissed — Both lessor and lessee agreed that holding of funds without lessor's authorization constituted breach of trust — Lessee was in breach from moment it retained sale proceeds without either remitting them to lessor or lessor's authorization — Breach continued until lessor's claim was either satisfied or compromised by Plan — Lessor, after acknowledging that there was breach of trust prior to Filing Date, could not identify post-Filing Date event to convert its entire claim to post-Filing claim — It was act of writing cheques and delivering them to payee that constituted breach of trust — Trial judge did not err in fixing date of breach to be when breach was being actively committed, as opposed to when it was allegedly being committed by omission.

Table of Authorities

Cases considered by *Kirkpatrick J.A.*:

Atlas Cabinets & Furniture Ltd. v. National Trust Co. (1990), 1990 CarswellBC 76, 38 C.L.R. 106, 45 B.C.L.R. (2d) 99, 68 D.L.R. (4th) 161, 37 E.T.R. 16 (B.C. C.A.) — referred to

Becker v. Pettkus (1980), 1980 CarswellOnt 299, 1980 CarswellOnt 644, [1980] 2 S.C.R. 834, 117 D.L.R. (3d) 257, 34 N.R. 384, 8 E.T.R. 143, 19 R.F.L. (2d) 165 (S.C.C.) — followed

British Columbia v. National Bank of Canada (1994), 30 C.B.R. (3d) 215, 6 E.T.R. (2d) 109, 52 B.C.A.C. 180, 86 W.A.C. 180, 2 G.T.C. 7348, 1994 CarswellBC 639, 99 B.C.L.R. (2d) 358, [1995] 2 W.W.R. 305, 119 D.L.R. (4th) 669 (B.C. C.A.) — referred to

Ellingsen, Re (2000), *(*sub nom. *Ellingsen (Trustee of) v. Hallmark Ford Sales Ltd.)* 190 D.L.R. (4th) 47, 7 B.L.R. (3d) 12, 1 P.P.S.A.C. (3d) 307, 19 C.B.R. (4th) 166, 2000 BCCA 458, 2000 CarswellBC 1684, *(*sub nom. *Ellingsen (Bankrupt), Re)* 142 B.C.A.C. 26, *(*sub nom. *Ellingsen (Bankrupt), Re)* 233 W.A.C. 26 (B.C. C.A.) — referred to

Garland v. Consumers' Gas Co. (2004), 2004 CarswellOnt 1558, 2004 CarswellOnt 1559, 2004 SCC 25, 72 O.R. (3d) 80 (note), 237 D.L.R. (4th) 385, 319 N.R. 38, 43 B.L.R. (3d) 163, 9 E.T.R. (3d) 163, 42 Alta. L. Rev. 399, 186 O.A.C. 128, [2004] 1 S.C.R. 629 (S.C.C.) — considered

Hewstan, Re (1996), 42 C.B.R. (3d) 186, 12 P.P.S.A.C. (2d) 36, 1996 CarswellBC 2134 (B.C. S.C. [In Chambers]) — considered

Hongkong Bank of Canada v. Chef Ready Foods Ltd. (1990), 51 B.C.L.R. (2d) 84, 1990 CarswellBC 394, 4 C.B.R. (3d) 311, *(*sub nom. *Chef Ready Foods Ltd. v. Hongkong Bank of Canada)* [1991] 2 W.W.R. 136 (B.C. C.A.) — considered

Stelco Inc., Re (2005), 2005 CarswellOnt 6818, 204 O.A.C. 205, 78 O.R. (3d) 241, 261 D.L.R. (4th) 368, 11 B.L.R. (4th) 185, 15 C.B.R. (5th) 307 (Ont. C.A.) — considered

1078385 Ontario Ltd., Re (2004), 2004 CarswellOnt 8041, 16 C.B.R. (5th) 144 (Ont. S.C.J.) — referred to

1078385 Ontario Ltd., Re (2004), 2004 CarswellOnt 8034, 16 C.B.R. (5th) 152, (sub nom. *1078385 Ontario Ltd. (Receivership), Re)* 206 O.A.C. 17 (Ont. C.A.) — considered

Statutes considered:

Companies' Creditors Arrangement Act, R.S.C. 1985, c. C-36
Generally — referred to

Personal Property Security Act, R.S.B.C. 1996, c. 359
Generally — referred to

s. 43 — considered

s. 51 — considered

s. 51(2) — considered

s. 51(2)(c) — referred to

s. 51(2)(d) — referred to

s. 68(1) — considered

APPEAL by lessor from judgment reported at *Caterpillar Financial Services Ltd. v. 360networks corp.* (2004), 7 P.P.S.A.C. (3d) 1, 10 E.T.R. (3d) 59, 4 C.B.R. (5th) 4, 35 B.C.L.R. (4th) 145, 2004 BCSC 1066, 2004 CarswellBC 1835 (B.C. S.C.), dismissing appeal from disallowance of claim and action for constructive trust over proceeds.

***Kirkpatrick J.A.*:**

1 The appellant, Caterpillar Financial Services Limited ("Caterpillar") appeals from the 11 August 2004 order of the Supreme Court that, with one relatively modest exception, denied Caterpillar's claim to recover the amounts owed to it under its equipment leases to the respondents, the 360 group of companies ("360"). Caterpillar's claims were determined in the context of proceedings under the *Companies' Creditors Arrangement Act*, R.S.C. 1985, c. C-36 ("*CCAA*"), in which 360 sought to reorganize its affairs.

Background

2 The background facts to this appeal are deceptively straightforward because, as it will become evident, application of the law to these facts is complex. The essential facts are as follows.

3 At all material times in question, 360 was involved in the development and construction of a worldwide fibre optic communications network. The work was initially undertaken by Ledcor Industries Limited. Ledcor Industries Limited subsequently transferred the fibre optic portion of its business to Ledcor Communications Ltd. in 1999. The trial judge found that Ledcor Communications Ltd. changed its name to 360fiber ltd. no later than on 28 June 2000.

4 Caterpillar is in the business of leasing heavy duty construction equipment. On 14 February 1997, 360fiber's pre-predecessor company, Ledcor Industries Limited, entered into a Master Finance Lease with Caterpillar. The lease contemplated that each piece of equipment (referred to as a "unit") leased by Caterpillar would be documented by a subsequently issued schedule. Essentially, each schedule constituted a separate lease agreement, but the provisions of the Master Finance Lease applied to each lease agreement.

5 On 30 March 1999, 360fiber's predecessor company, Ledcor Communications Ltd., entered into a new Master Finance Lease. Under the terms of that lease, 360fiber had the option at the end of the term of each lease agreement to purchase the equipment, return the equipment, or agree with Caterpillar to extend the term of the lease.

6 The governing Master Finance Lease provided:

> 4.1 Lessee shall not ... (f) sell, assign or transfer, or directly or indirectly create, incur or suffer to exist any lien, claim, security interest or encumbrance on any of its rights hereunder or in any Unit.
>
> . . .
>
> 4.6 The Units are and shall remain the personal property of Lessor irrespective of their use or manner of attachment to realty, unless such units are purchased by the Lessee at the end of the lease term or at such time as Lessee has paid to Lessor the "Balance Due" (as hereinafter defined).
>
> . . .
>
> 11. Unless assigned by Lessor or applicable law provides otherwise, title to and ownership of the Units shall remain in Lessor as security for the obligations of Lessee hereunder until Lessee has fulfilled all of such obligations. Lessee hereby grants to Lessor a continuing security interest in the Units ... and all proceeds of all of the foregoing, to secure the payment of all sums due hereunder.

"Balance Due" was defined under each Master Finance Lease as the sum of:

> (i) all amounts then due or accrued under this Lease with respect to such Unit, (ii) the present value of the entire unpaid balance of all rental for such Unit, and (iii) the present value of the ... "Purchase Option Price" ... of such Unit set forth on the applicable Schedule, (iv) less any insurance proceeds ...

Each of the schedules issued pursuant to the Master Finance Leases contained the following option:

> At the end of the Lease term with respect to the Units, provided this Lease has not been earlier terminated with respect to such Units, Lessee may by written notice to Lessor no more than 60 days prior to the end of the Lease Term with respect to any Unit, elect to purchase at the end of such term such Unit for the Purchase Price of $ ... If Lessee does not elect to purchase such Unit at the end of such term, Lessee shall return such Unit to Lessor as provided in Section 4 of the Master Finance Lease ...

7 This appeal centers on six units:

> (a) Unit 1 was leased for four years commencing April 1997. Financing statements were registered for this unit under s. 43 of the *Personal Property Security Act*, R.S.B.C. 1996, c. 359 ("*PPSA*"). However, Caterpillar did not file a financing change statement under s. 51 of the *PPSA* when Ledcor Communications Limited changed its name to 360fiber.
>
> (b) Unit 2 was leased for three years commencing August 1999. The trial judge found, and Caterpillar does not contest this finding on appeal, that Caterpillar failed to register a financing statement for this unit under the *PPSA*.
>
> (c) Unit 3 was leased for three years commencing August 1999. No financing statement was registered for this unit.
>
> (d) Unit 4 was leased for three years commencing December 1997. The term was extended for two years by a modification agreement. Caterpillar registered financing statements and financing change statements for this unit.
>
> (e) Unit 7 was leased for three years commencing April 2000. Financing statements and financing change statements were registered for this unit.

(f) Unit 8 was leased for one year commencing June 2000. The term was extended for three years by a modification agreement. Financing statements and financing change statements were registered for this unit.

8 The total amount claimed by Caterpillar in respect of these units was $785,392.27.

Disposition of the Units and Use of Sale Proceeds

9 By February 2001, 360 was experiencing financial difficulties. Consequently, 360 sought to dispose of its leased equipment. The trial judge accepted that, in late January or early February 2001, Caterpillar consented to 360fiber's sale of about 60 of Caterpillar's leased units during the currency of the applicable leases and subsequent retention of the "equity."

10 On 16 February 2001, 360fiber provided Caterpillar with a list of 66 units that were to be auctioned. The list did not include the six units that are the subject of this appeal.

11 In April 2001, 360fiber sold units 7 and 8 directly to a U.S. railroad company. The sale proceeds of $231,902.79 (U.S.) were deposited into 360's U.S. bank account on 9 May 2001. At the time of the deposit, the account had a credit balance. However, it went into an overdraft position by the close of business on 29 June 2001.

12 360 concedes that the sale of units 7 and 8, and the deposit of the proceeds therefrom into its U.S. account, was in breach of its covenant to pay Caterpillar under the Master Lease Agreement. However, Caterpillar recognizes its inability to trace the sale proceeds because 360 deposited the proceeds into an account that became overdrawn at the material time.

13 On 12 June 2001, Ritchie Bros. Auctioneers ("Ritchie") wrote two letters to Caterpillar. One letter was from Ritchie in Richmond, B.C., advising Caterpillar that on or about 26 June 2001, it was selling in Canada, the equipment described in two schedules attached to the letter. The letter requested Caterpillar to confirm if it had an interest in any of the pieces of equipment and, if so, to confirm that it would release its interest upon receipt of either a buyout amount indicated by Caterpillar as of 18 July 2001 or the net sale proceeds.

14 The second letter was from Ritchie in Portland, Oregon, advising Caterpillar that on or about 22 June 2001, Ritchie was selling in the U.S., the equipment described in the schedule attached to the letter. It similarly requested Caterpillar to confirm if it had an interest in any of the pieces of equipment and, if so, to confirm that it would release its interest upon receipt of either a buyout amount indicated by Caterpillar as of 16 July 2001 or the net sale proceeds.

15 In faxed responses to Ritchie, Caterpillar indicated a buyout figure beside each description of equipment in which it claimed an interest. Caterpillar indicated that it would release its interest in the equipment upon receipt of the buyout amounts.

16 Units 1, 3 and 4 were included in the schedule attached to the Canadian letter. Caterpillar failed to quote a figure or otherwise indicate an interest in those units.

17 Unit 2 was included in the schedule attached to the U.S. letter. Again, Caterpillar failed to quote a figure or otherwise indicate an interest in this unit.

18 The U.S. auction was held on or about 22 June 2001. The net proceeds, including those from the sale of unit 2, were $863,563.34 (U.S.). On or about 11 July 2001, Ritchie distributed the net sale proceeds by forwarding $760,470 (U.S.) to Caterpillar and $103,093.34 (U.S.) to 360. 360 deposited the cheque into its U.S. current account in Vancouver on 15 August 2001, at which time the account was in an overdraft position.

19 The Canadian auction was held on or about 26 June 2001. The net proceeds, including those from the sale of units 1, 3 and 4, were $827,365.94. On or about 13 July 2001, Ritchie distributed the net sale proceeds by forwarding

$178,556.89 to another equipment lessor and $648,809.05 to 360. 360 deposited the cheque into its current account in Vancouver on 15 August 2001, at which time the account was in an overdraft position.

360's CCAA Proceedings

20 During the period 360 was disposing of the leased equipment, it was also planning to restructure its affairs under the *CCAA*. On 28 June 2001 (the "Filing Date"), 360 commenced proceedings under the *CCAA*. The initial stay order was obtained on the Filing Date. The confirmation order granted on 20 July 2001 contained, *inter alia*, a stay of all proceedings against 360. Most significantly, the initial stay order and the confirmation order restricted 360 to payment of obligations incurred only after the Filing Date to persons who advance or supply goods after the Filing Date. 360 could make no payments on account of amounts owed by it to its creditors as of the Filing Date.

21 Approximately one year later, on 24 July 2002 (the strongest candidate for the "Plan Filing Date"), the trial judge (who managed the case from the commencement of the *CCAA* proceedings) granted the procedural order that authorized 360 to file a plan of arrangement (the "Plan") substantially in the form of a plan dated 18 July 2002 and that set out the mechanisms for the filing of proofs of claim by creditors, the disallowance of claims by 360, and appeals from disallowances.

22 Caterpillar submitted its proof of claim on or about 19 September 2002 and when 360 disallowed the claim, Caterpillar appealed the disallowance.

23 On 27 August 2002, the requisite majorities of 360's creditors approved the Plan. The Supreme Court sanctioned the Plan on 4 September 2002.

24 The Plan contained numerous conditions precedent, including the resolution of Caterpillar's claims. It established two classes of creditors: the Senior Lenders and the General Creditors. The Senior Lenders, of which JPMorgan Chase Bank was the agent, were to receive $135 million in cash, new secured notes in the amount of $215 million, and 80.5% of the equity of 360networks corporation. The Senior Lenders underwrote the *CCAA* proceedings by providing funding to 360 during the restructuring process. The amount owed to the Senior Lenders as of the Filing Date was $1.176 billion (U.S.). The Plan specified that it did not affect or compromise the claims of certain specified creditors, including:

> **3.3 Unaffected Creditors**
>
> This Plan does not affect or compromise the Claims of the following Creditors and other Persons:
>
>> (a) Post-Filing Claims of any Person;
>>
>> . . .
>>
>> (g) Claims of Secured Creditors (including Lien Creditors but excluding the Senior Lenders) to the extent that the Charge of such Secured Creditors against any affected assets, property and undertaking of any one of the Canadian Companies <u>was properly registered or perfected on the Filing Date, up to the realizable value of such assets as determined pursuant to the Procedural Order</u>, except to the extent provided for in section 3.4 hereof.
>
> [Emphasis added.]

25 Section 3.4 of the Plan reads:

> **3.4 Affected Claims of Secured Creditors**
>
> Secured Creditors other than Senior Lenders shall have no Voting Claim or Distribution Claim, except to the extent of any Deficiency Claim to which they may be entitled, in respect of the realizable value of the collateral for which a

Charge has been properly registered or perfected by them, which value shall be determined by agreement between the Canadian Companies and such Secured Creditors, or by Order of the Court. The Canadian Companies shall satisfy their obligations to the Secured Creditors (other than in respect of that portion of the obligation which constitutes a Deficiency Claim) in accordance with the terms of the relevant security agreement ...

26 Certain definitions from the Plan are relevant to this appeal:

"Charge" means a valid and enforceable security interest, lien, charge, pledge, encumbrance, ... on any assets, property or proceeds of sale of any of the Canadian Companies or a right of ownership on any equipment which was leased by any of the Canadian Companies.

"Claim" means any right or claim of any Person against any one or more of the Canadian Companies whatsoever, ... in connection with any indebtedness, liability or obligation of any kind of the Canadian Companies, which indebtedness, liability or obligation is in existence at the Filing Date and which is not a Post-Filing Claim, and any interest that may accrue thereon up to and including the Filing Date where there is an obligation to pay such interest, pursuant to the terms of any contract with such Person by operation of law or in equity, whether or not reduced to judgment, liquidated, unliquidated, fixed, contingent, matured, unmatured, disputed, undisputed, legal, equitable, secured, unsecured, perfected, unperfected, present, future, ...based in whole or in part on facts which exist on or before the Filing Date, together with any other claims that would have been claims provable in bankruptcy had the Canadian companies become bankrupt on the Filing Date including, without restriction, a claim arising after the Filing Date as a result of the termination of an executory contract or lease by any of the Canadian Companies as part of the restructuring of the business of the Canadian Companies.

"Creditor" means any Person having a Claim or a Post-Filing Claim against any one of the Canadian Companies

. . .

"Deficiency Claim" means that portion of the Claim of a Secured Creditor for which there would be no realizable value on liquidation of the Charge held by such Secured Creditor and which constitutes a General Creditor Claim under the Plan.

"Plan Filing Date" means the date upon which this Plan is first filed with the Court in the CCAA Proceedings.

"Secured Creditors" means any Creditor asserting a Charge, including the Senior Lenders and the Lien Creditors.

27 The Plan essentially provided that Secured Creditors' security agreements would be honoured as long as the realizable value of the assets covered by the security agreement was equal to or greater than the amount due under the security agreement. If the realizable value was less than the amount owed under the security agreement, the Plan treated the creditor as an unsecured creditor for the amount of the shortfall or deficiency and as a secured creditor to the extent of the realizable value of the assets.

28 A significant flaw in the procedural order of 24 July 2002 was the absence of a mechanism for determining the realizable value of assets. Further, the order was silent as to the date on which that determination was to be made: this date came to have critical importance.

29 If the relevant date was the Filing Date (28 June 2001), the proceeds of sale of the units were traceable and exceeded the amounts owed by 360 under the lease agreements. In this scenario, Caterpillar would not have a Deficiency Claim in respect of any of the units and would be entitled to payment in full.

30 However, if the relevant date was the Plan Filing Date (24 July 2002), the sale proceeds, having been deposited into bank accounts that were either overdrawn or became overdrawn by 24 July 2002, were no longer traceable and the realizable value of Caterpillar's collateral in the units was zero. In this scenario, Caterpillar would have a Deficiency Claim in the full amounts owed under the lease, which would be compromised under the Plan.

31 The Plan clarified that the treatment of claims was final and binding on all creditors.

The Trial Judgment

32 Caterpillar appealed from 360's disallowance of its claims in the *CCAA* proceeding. In addition, Caterpillar was granted leave to commence a separate action in which it claimed, *inter alia*, that it had a constructive trust over all the sale proceeds of the units.

33 The trial judge heard both actions at the same time. He framed the issues as follows at para. 34 of his reasons ((2004), 4 C.B.R. (5th) 4, 35 B.C.L.R. (4th) 145 (B.C. S.C.)):

> [34] The issues raised in the CCAA appeal and Action No. LO32238, as framed by counsel for Caterpillar but in my words, are as follows:
>
> > (a) is Caterpillar a Secured Creditor under the Plan entitled to payment under its lease agreements covering the Units (the "Lease Agreements") pursuant to section 3.4 of the Plan?
> >
> > (b) does Caterpillar have Post-Filing Claims under the Plan as a result of breaches of constructive trusts after the Filing Date?
> >
> > (c) what is the amount owed to Caterpillar in respect of the Units which was not compromised by the Plan?

34 As the trial judge noted, Caterpillar abandoned its claim that it was entitled to a trust over all of 360's assets or that it could trace the proceeds from the sales of the units.

35 The trial judge concluded as follows:

> (a) Caterpillar fell within the definition of "Secured Creditor" as defined by the Plan. However, the full amounts owing under the lease agreements were compromised by the Plan as Deficiency Claims. This conclusion was premised on the trial judge's determination that the date for ascertaining the realizable value of Caterpillar's collateral was the Plan Filing Date (24 July 2002).
>
> (b) Caterpillar was not entitled to a declaration of constructive trust over the sale proceeds from units 1, 2 and 3, but was entitled to such a declaration to the extent of the buyout amounts under the relevant lease agreements in respect of units 4, 7 and 8. The trial judge noted that 360 improperly sold *the units themselves*, as opposed to *its rights in any units*. Further, the trial judge concluded that there were two independent juristic reasons for 360's enrichment in respect of units 1, 2 and 3. The first concerned Caterpillar's general agreement that 360 could sell equipment and retain the "equity". The second concerned the Senior Lenders' priority in respect of units 1, 2 and 3 by reason of Caterpillar's failure to perfect its security in units 2 and 3, and its failure to register a financing change statement in respect of unit 1. Consequently, Caterpillar's claim for unjust enrichment applied only to units 4, 7 and 8.
>
> (c) The breach of trust relating to the sale proceeds from unit 4 constituted a Post-Filing Claim that was not compromised by the Plan. This conclusion rested on the trial judge's determination as to when the breach of trust occurred. The trial judge decided that in respect of units 7 and 8, it was at one of two dates: either when 360 received the proceeds and deposited them into its bank account without remitting the buyout amounts to Caterpillar (9 May 2001) or when the funds were no longer available to 360 to reduce its indebtedness to others. Although the trial judge favoured the first date, he found it unnecessary to decide the issue because in either case, the breach occurred before the Filing Date (28 June 2001). He therefore concluded that the claims in respect of units 7 and 8 were pre-filing claims that were compromised by the Plan. In contrast, because the proceeds from the sale of unit 4 were deposited into 360's overdrawn bank account on 15 August 2001, it constituted a Post-Filing Claim.

Issues

36 Caterpillar alleges that the trial judge erred:

(a) in law, in relation to Caterpillar's claim for payment in full as a Secured Creditor under the Plan, in finding that the date for determination of the realizable value of the sale proceeds of the Units was to be a date after the proceeds had been wrongfully used by 360 to reduce its own indebtedness.

(b) in law, in relation to Caterpillar's claim for a constructive trust over the sale proceeds of Units 1, 2 and 3, in finding that the priority of the general security held by 360's bankers was (a) relevant to a Post Filing Claim and (b) properly a factor to be considered in determining whether to declare the constructive trust.

(c) in law, in relation to Caterpillar's claim for damages for breach of the constructive trust declared by the court over the proceeds of sale of Units 7 and 8, in finding that the only acts relevant to the claim of breach of trust occurred before the Filing Date.

(d) in law, further in relation to Caterpillar's claim for damages for breach of the constructive trust declared by the court over the proceeds of sale of Units 7 and 8, in finding that it was the act of writing the cheques on the trust funds' bank account which constituted the breach of trust, rather than the actual withdrawal of funds.

37 Caterpillar's grounds of appeal are conveniently divided into two categories: those that relate to its claims as a Secured Creditor (ground (a)) and those that relate to its claims under constructive trust principles (grounds (b), (c) and (d)).

Discussion

Secured Creditor Claim

38 As I have noted, the trial judge found that Caterpillar was a Secured Creditor as defined by the Plan. Caterpillar agrees with this finding. Conversely, while 360 agrees with the final outcome, it takes issue with this finding.

39 In any event, Caterpillar submits that the Plan could have simply specified that the court determine the priorities of competing security interests prior to paying the Secured Creditors. Caterpillar contends that the Senior Lenders, by approving the Plan, agreed to forego priority battles and essentially allowed each Secured Creditor to be paid according to the Plan.

40 Caterpillar thus argues that priority issues have no place in *CCAA* proceedings. 360, on the other hand, argues that priority issues are central to this case.

41 At this point, it is instructive to consider the purpose of the *CCAA* regime. This Court in *Hongkong Bank of Canada v. Chef Ready Foods Ltd.* (1990), 51 B.C.L.R. (2d) 84, [1991] 2 W.W.R. 136 (B.C. C.A.) at paras. 10 and 22 stated:

[10] The purpose of the C.C.A.A. is to facilitate the making of a compromise or arrangement between an insolvent debtor company and its creditors to the end that the company is able to continue in business.

. . .

[22] The C.C.A.A. was enacted by Parliament in 1933 when the nation and the world were in the grip of an economic depression. When a company became insolvent liquidation followed because that was the consequence of the only insolvency legislation which then existed — the *Bankruptcy Act* and the *Winding-up Act*. Almost inevitably liquidation destroyed the shareholders' investment, yielded little by way of recovery to the creditors, and exacerbated the social evil of devastating levels of unemployment. The government of the day sought, through the C.C.A.A., to create a regime whereby the principals of the company and the creditors could be brought together under the

supervision of the court to attempt a reorganization or compromise or arrangement under which the company could continue in business.

42 While it might be suggested that *CCAA* proceedings may require those with a financial stake in the company, including shareholders and creditors, to compromise some of their rights in order to sustain the business, it cannot be said that the priorities between those with a financial stake are meaningless. The right of creditors to realize on any security may be suspended pending the final approval of the court, but this does not render their potential priority nugatory. Priorities are always in the background and influence the decisions of those who vote on the plan.

43 In "Reorganizations under the Companies' Creditors Arrangement Act" (1947) 25 Canadian Bar Rev. 587 at 595-97, the learned author Stanley E. Edwards explains the necessity of considering priorities in *CCAA* proceedings:

> In order to make an equitable redistribution of the securities of a company and the other claims against it, it is important to classify the creditors and shareholders according to their contract rights. Most important will be their respective rights of participation in the distribution of the company's income while it is operating, and its assets on liquidation. <u>Included also will be the power which secured creditors would have but for the C.C.A.A. to realize upon the property by foreclosure in priority to other claimants</u>. I would suggest that the aspect of these rights to be first considered should be not their face or nominal value, but rather what they would in reality be worth if the company had been liquidated rather than reorganized. This would entail a valuation and estimate of what the assets would bring at a public sale, or be worth to the secured creditors upon foreclosure. There can hardly be a dispute as to the right of each of the parties to receive under the proposal at least as much as he would have received if there had been no reorganization...
>
> ...<u>The United States Supreme Court</u> by adopting the absolute priority doctrine as a "fixed principle", <u>has in effect compelled the full recognition in a plan of all of the former nominal participation rights of senior claimants in priority to any rights of junior creditors or stockholders</u>. It has held that although the requirements of feasibility may preclude giving senior claimants the same type of participation as they had before, they may be compensated for giving up seniority or a high interest rate by giving them a larger face value of inferior securities or some other concession. This rule...may well necessitate the exclusion of some of the junior classes from any participation in the reorganized company...
>
> In England, on the other hand, the courts will sanction any scheme if the formal statutory requirements have been satisfied and <u>if the senior classes obtain at least what they would be entitled to on liquidation</u>, regardless of how the increase in value resulting from the reorganization is distributed...
>
> ...it would seem to me that considerations of policy point to the desirability of adopting the American rule... [Emphasis added.]

44 According to Edwards (at 603), priorities are also relevant in the classification of creditors under the *CCAA*:

> [T]he court should examine the nature of the claims of the creditors in order to classify them properly. For example, no two secured creditors should be grouped together unless their security is on the same or substantially the same property and <u>in equal priority</u>. Further divisions may be made on the basis of other legal preferences or according to whether the claim is liquidated or unliquidated, absolute or contingent. [Emphasis added.]

45 In *Stelco Inc., Re* (2005), 204 O.A.C. 205, 78 O.R. (3d) 241 (Ont. C.A.), the court articulated relevant principles in determining "commonality of interest" for *CCAA* classification purposes. The court stated as follows at para. 23:

> In *Canadian Airlines Corp., Re* (2000), 19 C.B.R. (4th) 12 (Alta. Q.B.), Paperny J. nonetheless extracted a number of principles to be considered by the courts in dealing with the commonality of interest test. At para. 31 she said:
>
> > In summary, the cases establish the following principles applicable to assessing commonality of interest:

> . . .
>
> 2. The interests to be considered are the legal interests that a creditor holds qua creditor in relationship to the debtor company prior to and under the plan as well as on liquidation.
>
> . . .

46 The Ontario Court of Appeal's decision in *1078385 Ontario Ltd., Re* (2004), 206 O.A.C. 17, 16 C.B.R. (5th) 152 (Ont. C.A.) [*Bob-Lo Island*] suggests that secured creditors may assume a leadership role in a restructuring process that has traditionally been directed by debtor companies to the company's general benefit. Further, the decision appears to create an opportunity for secured creditors to use the *CCAA* as an efficacious shortcut to enforce their security. Ultimately, *Bob-Lo Island* represents the evolution of the role of secured creditors under the *CCAA*, and the use of the statute as a flexible and advantageous restructuring tool for secured creditors. The Ontario Court of Appeal, in dismissing a motion for leave to appeal a decision of the Ontario Superior Court of Justice, held that the fact that a plan of arrangement under the *CCAA* is put forth by a secured creditor, which plan vests all of the debtor company's assets into a non-arm's length purchaser and operates exclusively for the benefit of secured creditors, does not, in and of itself, negate the fairness and reasonableness of such a plan where it can be shown that, even outside of the plan, the assets of the debtor company will not generate any recovery for unsecured creditors. In response to the argument that the plan was a shortcut in the realization of assets without regard to traditional means of enforcing security, the Superior Court noted at para. 125: "To a certain extent, that is true, but I think that is the nature of the CCAA" ((2004), 16 C.B.R. (5th) 144 (Ont. S.C.J.)).

47 As I have said, Caterpillar agrees with the trial judge's finding that it was a Secured Creditor as defined by the Plan. However, Caterpillar contends that the trial judge erred in finding that the date for determining realizable value was the Plan Filing Date (24 July 2002).

48 The dispute arises because, contrary to s. 3.3(g) of the Plan, the procedural order did not contain a mechanism for determining the realizable value of assets. The trial judge resolved the issue as follows at paras. 43-47:

> [43] The Plan does not provide any clear assistance by specifying the date on which the realizable value of secured assets should be determined. Clause (g) of section 3.3 refers to the realizable value of the assets "as determined pursuant to the Procedural Order", which, as mentioned above, does not contain a mechanism other than the proof of claim process. Section 3.4 provides that the value is to be "determined by agreement between the Canadian Companies and such Secured Creditors, or by Order of the Court".
>
> [44] It is my view that, in the absence of a specific date being identified, the effective date of the valuation of the assets should be the date on which the Plan was formerly [sic] issued (namely, the Plan Filing Date). As was stated at section 4.13 of The Interpretation of Contracts 2nd ed. (London: Sweet & Maxwell, 1997):
>
> > Since a contract must be interpreted as at the date when it was made, words must be given the meaning which they bore at that date ...
>
> In referring to the realizable value of the assets, the Plan must be taken to mean the current realizable value. It would not make sense for 360 to pay more for the asset than it was worth at the time 360 issued the Plan. Put in the context of the present circumstances, it would not make sense for 360 to agree to make payments under leases when it did not intend to use the leased equipment in its future operations.
>
> [45] If it had been the intention that the realizable value of assets was to be determined as of a date other than the current date, it would have been very easy to specify an earlier date. For example, the requirement in clause (g) of section 3.3 for the proper registration or perfection of the Charge was that it be "registered or perfected on the Filing Date". The very next phrase in clause (g) makes reference to the realizable value of the assets but does not contain the same words "on the Filing Date". The drafter's mind had been directed to the "Filing Date" when drafting clause

(g) and the absence of those words to modify the phrase "the realizable value of such assets" suggests that it was not the intention to have the assets valued as at the Filing Date.

[46] Support for this interpretation is found in the definition of "Equipment Lessor", which was defined to mean a Creditor holding a title interest in relation to equipment in the possession of the Canadian Companies at the Filing Date "which remains in the possession of the Canadian Companies on the Plan Filing Date". Caterpillar does not actually fall within this definition because the units were not in the possession of 360fiber at the Filing Date, but it is instructive of the Plan's treatment of equipment lessors generally.

[47] The term "Equipment Lessor" was used in the definition of "General Creditor" ("... in the case of an Equipment Lessor, any arrears outstanding as at the Filing Date"). General Creditors were the creditors whose claims were compromised under the Plan. The Plan demonstrates that it was the intention to require 360 to make payments on leases only if it would be using the leased equipment in its future operations (but excluding arrears owing on the Filing Date, which would be treated as an unsecured or general claim). The manner in which the definition of "Equipment Lessor" was drafted suggests that the full amounts owing under leases of equipment no longer in the possession of 360 on the Plan Filing Date would be compromised under the Plan.

49 Caterpillar submits that since the drafters of the Plan omitted to articulate a mechanism for determining realizable value, the Plan itself should be of no use in making such determination. Ultimately, Caterpillar proposes that the proper date for valuation is the date on which the assets were "used" by 360 to reduce its indebtedness to others.

50 In my opinion, Caterpillar's arguments cannot succeed. In the absence of a specified date for calculating realizable value, the trial judge considered all other reasonable sources for determining that critical date. To suggest that the Plan should not be considered in making this determination is unreasonable. It is true that the Plan contemplated that the procedural order would specify a mechanism for determining realizable value. However, the fact that the expectation was never realized does not render the Plan barren of meaning in this regard.

51 Caterpillar's proposition — that the proper date for valuation of the assets is the date on which they were "used" by 360 contrary to the lease agreements or, if they were not "used" and hence still in existence, the date of the Plan (by which I assume Caterpillar to mean the Filing Date) — ignores the necessity of orderliness in *CCAA* proceedings, which the trial judge was obviously at pains to impose in the case at bar. It would make little practical sense to determine realizable value before the Plan had been authorized to be put to creditors unless, of course, the Plan or procedural order so specified. Further, the alternative date proposed by Caterpillar (i.e. when the assets were used by the debtor to reduce its indebtedness to others) would yield unnecessary complexity and uncertainty. When could it be said that assets were "used"? Even if one could define when an asset was so "used", this formula would result in different valuation dates depending on when each asset was used.

52 There can be no doubt that Caterpillar's security position was eroded between the Filing Date and the Plan Filing Date. However, Caterpillar had knowledge that 360 intended to sell Caterpillar's collateral. Conceivably, Caterpillar could have acted promptly to protect its position. It had sufficient opportunity to demand payment prior to the Filing Date. After the Filing Date, 360 was prohibited by the terms of the initial order to make any payments to creditors holding a pre-filing claim. Ultimately, Caterpillar's inaction contributed to the risk that materialized.

53 In these circumstances, I am not persuaded that the trial judge erred in finding that the proper date for determining the realizable value of the assets was the Plan Filing Date (24 July 2002). Accordingly, it is unnecessary to decide whether, as 360 contends, the trial judge was in error in concluding that Caterpillar was a Secured Creditor as defined by the Plan.

Constructive Trust Issues

Units 1, 2 and 3

54 First, Caterpillar contends that the trial judge erred in relation to its claim for a constructive trust over the sale proceeds of units 1, 2 and 3 in finding that the priority of the general security held by 360's bankers was relevant to a Post-Filing Claim and properly a factor to be considered in determining whether to declare a constructive trust.

55 The trial judge applied the well-known test for unjust enrichment articulated in *Becker v. Pettkus*, [1980] 2 S.C.R. 834, 34 N.R. 384 (S.C.C.) at para. 38. The test features three elements: first, an enrichment; second, a corresponding deprivation; and third, an absence of any juristic reason for the enrichment. 360 conceded that Caterpillar, in not receiving the sale proceeds from the units, suffered a deprivation. The trial judge found an enrichment by 360 in the form of a reduction in its indebtedness. However, as I have noted, the trial judge found two independent juristic reasons for the deprivation. First, Caterpillar agreed to 360's sale of the leased equipment and subsequent retention of the "equity". Second, the Senior Lenders enjoyed priority over Caterpillar in respect of units 1, 2 and 3 because of the failure of the latter to perfect its security over these units.

56 Caterpillar's argument rests on its assertion that constructive trust claims must be analyzed as Post-Filing Claims as defined by the Plan:

> ... any right or claim of any person against the Canadian Companies ... arising from or caused by, directly or indirectly, any action taken by the Canadian Companies from and after the Filing Date [28 June 2001].

57 However, this analysis ignores the essential question of when the claim to any constructive trust arose. There is no Post-Filing Claim if the right to assert the claim arose prior to the Filing Date. In my opinion, Caterpillar's argument is unsustainable because it rests on a logical fallacy. Caterpillar prematurely assumes the existence of a constructive trust. The proper approach is to determine whether a constructive trust arises *before* characterizing it as a Post-Filing Claim.

58 360 opposes the imposition of a common law constructive trust as being inconsistent with the priority provisions of the *PPSA*. In support of its contention, 360 relies on s. 68(1) of the *PPSA:*

> The principles of the common law, equity and the law merchant, <u>except insofar as they are inconsistent with the provisions of this Act</u>, supplement this Act and continue to apply. [Emphasis added.]

360 thus argues that Caterpillar is prevented from correcting its own defective registration and perfection in units 1, 2 and 3 by asserting a constructive trust.

59 I recognize that Caterpillar's loss did not, strictly speaking, arise from its failure to *register or perfect* its security. Rather, Caterpillar's loss was the product of its failure to *protect* its security upon receiving notice that 360 intended to sell the units. The leases merely permitted 360 to sell its *rights* to the units. Thus, the sales intended, and in fact carried out, by 360 constituted a blatant breach of the leases.

60 The trial judge addressed this issue at paras. 53 and 54:

> [53] The second reason proffered by counsel for 360 (as well as counsel for the Senior Lenders) relates to the criterion of an absence of juristic reason as well as the criterion of an enrichment. Counsel for 360 and the Senior Lenders relies upon the following passage from *Luscar Ltd. v. Pembina Resources Ltd.* (1994), 162 A.R. 35 (C.A.):
>
>> Where there exists a contract under which parties are governed, and one party gains by a breach of the same, that party is not truly enriched, because the breaching party takes that gain subject to its liability for breach of contract. If the other party does not sue within the time set out in the Limitations Act, then, without more, there is a juristic reason for the gain because the breaching party is entitled to rely on the intended limitation.
>>
>> (¶ 117)

> In my opinion, this passage does not apply to the present circumstances. 360fiber already had the contractual obligation to pay the amounts owing under the Lease Agreements prior to the sale of the Units. Its sale of the Units, and retention of the sale proceeds, was not subject to any consequential liability under the Lease Agreements. It was enriched without any new offsetting liability.
>
> [54] In addition, I do not believe that the sale of the Units by 360fiber was merely a breach of the Lease Agreements. It was prohibited by the terms of the Lease Agreements from selling its rights in any Unit, but it did more than simply sell its rights. It sold the Units themselves, including Caterpillar's ownership interests, as a result of an auctioneer's ability to convey title to purchasers. The sale of the Units constituted a wrong which cannot be properly characterized solely as a breach of contract. 360fiber did not have the right to sell the Units because Caterpillar owned them, not because the Lease Agreements prohibited the sale of the Units (what the Lease Agreements prohibited was the sale by 360fiber of its rights in the Units). It is true that I have found that Caterpillar gave a general consent to sales of its equipment by 360fiber. However, the consent was subject to the condition that Caterpillar would be paid the buyout amounts under each lease agreement, and this condition was never satisfied in relation to the Units.

61 The availability of a remedial constructive trust in the commercial context has been the subject of considerable academic and judicial debate: see e.g. *Ellingsen, Re* (2000), 142 B.C.A.C. 26, 190 D.L.R. (4th) 47 (B.C. C.A.); *Atlas Cabinets & Furniture Ltd. v. National Trust Co.* (1990), 45 B.C.L.R. (2d) 99, 68 D.L.R. (4th) 161 (B.C. C.A.); *British Columbia v. National Bank of Canada* (1994), 52 B.C.A.C. 180, [1995] 2 W.W.R. 305 (B.C. C.A.). In particular, the existence of a contractual relationship between the plaintiff and defendant may preclude the imposition of a constructive trust. The general principle is stated by David M. Paciocco in "The Remedial Constructive Trust: A Principled Basis for Priorities and over Creditors", (1989) 68 Canadian Bar Rev. 315 at 341-42:

> There is widespread agreement that a party who has accepted the role of a general creditor should be denied proprietary relief. The decision in *Sinclair v. Brougham* is often used to make the point. There the depositors of the bank entered into their transactions with the expectations that they would be unsecured creditors of the bank. Allowing them to trace therefore gave them proprietary protection which was never expected. Only an out of court settlement with the other general creditors of the bank and the condition imposed by the court that the depositors recognize the claims of the shareholders prevented this from producing an unwarranted priority. It has therefore been suggested that:
>
>> As a general principle, ... people who willingly choose to become unsecured creditors of an eventual bankrupt ought not to be given priority over other unsecured creditors through the extended use of the constructive trust remedy.
>
> There are two kinds of case where a claimant can be considered, every bit as much as the general creditors can, to have accepted the risk of the defendant's insolvency: where there are contractual dealings between the plaintiff and defendant which anticipate that the plaintiff will assume the status of a general creditor; and where the plaintiff's claim rests on a *quantum meruit* or *quantum valebat* basis in situations where there has been no reasonable expectation by the plaintiff of acquiring a proprietary interest.

62 The application of this principle to the circumstances at bar is far from straightforward. Nonetheless, it is clear that when Caterpillar entered into the leases, it intended to secure the obligations owed by 360 by retaining title to the units. Pursuant to the *PPSA*, Caterpillar could perfect its security by registration. The failure to register or perfect its security meant that, as between Caterpillar and any third parties, Caterpillar was a general creditor in respect of units 2 and 3. Although Caterpillar had negotiated with 360 to be a secured creditor, it ultimately failed to protect its status as a secured creditor under the *PPSA*. As such, Caterpillar must be taken to have accepted the risk posed by 360's eventual insolvency. In my view, Caterpillar should not be able to invoke constructive trust principles to alter its reduced creditor status.

63 The trial judge instead adopted the analysis of the Supreme Court of Canada in *Garland v. Consumers' Gas Co.*, [2004] 1 S.C.R. 629, 237 D.L.R. (4th) 385 (S.C.C.) at paras. 44-46:

> [44] The parties and commentators have pointed out that there is no specific authority that settles this question. But recalling that this is an equitable remedy that will necessarily involve discretion and questions of fairness, I believe that some redefinition and reformulation is required. Consequently, in my view, the proper approach to the juristic reasons analysis is in two parts. First, the plaintiff must show that no juristic reason from an established category exists to deny recovery. By closing the list of categories that the plaintiff must canvas in order to show an absence of juristic reason, Smith's objection to the Canadian formulation of the test that it required proof of a negative is answered. The established categories that can constitute juristic reasons include a contract (*Pettkus*, *supra*), a disposition of law (*Pettkus*, *supra*), ... and other valid common law, equitable or statutory obligations (*Peter*, *supra*). If there is no juristic reason from an established category, then the plaintiff has made out a *prima facie* case under the juristic reason component of the analysis.
>
> [45] The *prima facie* case is rebuttable, however, where the defendant can show that there is another reason to deny recovery. As a result, there is a de facto burden of proof placed on the defendant to show the reason why the enrichment should be retained. This stage of the analysis thus provides for a category of residual defence in which courts can look to all of the circumstances of the transaction in order to determine whether there is another reason to deny recovery.
>
> [46] As part of the defendant's attempt to rebut, courts should have regard to two factors: the reasonable expectations of the parties and public policy considerations. It may be that when these factors are considered, the court will find that a new category of juristic reason is established. In other cases, a consideration of these factors will suggest that there was a juristic reason in the particular circumstance of a case but which does not give rise to a new category of juristic reason that should be applied in other factual circumstances. In a third group of cases, a consideration of these factors will yield a determination that there was no juristic reason for the enrichment. In the latter cases, recovery should be allowed. The point here is that this area is an evolving one and that further cases will add additional refinements and developments.

64 Under either analysis, Caterpillar appears to be employing the remedy of a constructive trust to vault its security position in respect of units 1, 2 and 3, contrary to the provisions of the *PPSA* and the general framework of the *CCAA*.

65 In any event, I am unable to say that the trial judge erred in his analysis. Caterpillar satisfied the initial burden of showing there was no established category of juristic reason to defeat its claim. However, the trial judge proceeded to find two other juristic reasons, one of which was Caterpillar's failure to perfect its interest and the Senior Lenders' ensuing priority over Caterpillar with respect to units 1, 2 and 3.

66 Further, I respectfully agree with the trial judge's alternative reason for refusing to declare a constructive trust in respect of units 1, 2 and 3 (at para.68):

> [68] If I am mistaken and the priority of the Senior Lenders over the security interest of Caterpillar in Units 1, 2 and 3 is not a juristic reason to prevent the declaration of a constructive trust, the rights of the Senior Lenders must still be taken into account before a constructive trust is declared. Lambert J.A. said the following in the Ellingsen decision:
>
>> A remedial constructive trust will be imposed only if it is required in order to do justice between the parties in circumstances where good commercial conscience determines that the enrichment has been unjust. But a remedial constructive trust is a discretionary remedy. It will not be imposed where an alternative, simpler remedy is available and effective. And it will not be imposed without taking into account the interests of others who may be affected by the granting of the remedy. In this case that would include other creditors of the bankrupt, (both secured creditors and general creditors, since the trust may defeat both), and any relevant third parties. (¶ 71)

> If the priority of the Senior Lenders over Caterpillar is not a juristic reason and Caterpillar would have met the criteria of unjust enrichment in respect of Units 1, 2 and 3, I would exercise my discretion to decline to order a constructive trust over the proceeds from the sales of Unit 1, 2 and 3 as a result of the priority of the Senior Lenders over Caterpillar with respect to these proceeds.

67 Before leaving this ground of appeal, I note that while Caterpillar concedes its failure to file a name change under s. 51 of the *PPSA* for unit 1, it cites *Hewstan, Re* (1996), 42 C.B.R. (3d) 186, 12 P.P.S.A.C. (2d) 36 (B.C. S.C. [In Chambers]) at para. 31 to support its assertion that perfection is undisturbed.

68 Subsection 51(2) addresses the scenario in which a security interest is perfected by registration, but there is a subsequent change in the debtor's name and the secured party knows of the change of name. The subsection places an obligation on the secured party to either amend the registration by registering a financing change statement disclosing the new name of the debtor or perfect its security by taking possession of the collateral. One of these measures must be taken within the time specified.

69 The failure to comply with the requirement has different priority consequences depending on the type of interest in competition with the security interest. First, the security interest is subordinate to *any interest*, *other than a competing security interest*, arising after the expiry of 15 days from the date the secured party acquired knowledge as to the debtor's new name. Second, the security interest is subordinate to a security interest that is registered or perfected after the expiry of 15 days from the date the secured party acquired knowledge as to the new name of the debtor. Finally, the security interest is subordinate to a security interest that is registered or perfected after the secured party acquired knowledge of the new name of the debtor and before the section has been complied with. However, if the secured party complies with the section or takes possession of the collateral before the expiry of the aforementioned 15-day period, but after the competing security interest is registered or perfected, the perfected status of its security interest remains unaffected.

70 The underlying purpose of s. 51 is to preserve the integrity and utility of the registry when the debtor's name has changed. This change impacts the ability of a searching party to discover the existence of a security interest. Unless the secured party is obliged to amend its registration to reflect the debtor's name change, a search result obtained on the basis of the name of the person in possession or legal control of the property will fail to disclose the registration.

71 *Hewstan, Re* concerns the narrow issue of whether a trustee in bankruptcy qualifies as a person who has an "interest" in collateral. In contrast, the instant case does not deal with the issue of a trustee in bankruptcy's interest pursuant to s. 51(2)(c). It centers on s. 51(2)(d): the priority of Caterpillar in relation to that of a competing security interest. In *Hewstan, Re*, the chambers judge properly noted that s. 51(2) does not render a security interest "unperfected". Failure to file a notice of name change does not undermine the validity of registration of a security interest. It solely impacts priority. Application of s. 51(2) of the *PPSA* results in Caterpillar's perfected security interest with respect to Unit 1 being subordinate to the Senior Lenders' perfected security interest.

72 For the foregoing reasons, I am not persuaded that there is any merit in Caterpillar's second ground of appeal.

Units 7 and 8

73 As I have already noted, the trial judge declared constructive trusts in favour of Caterpillar over the proceeds of sale of units 4, 7 and 8, to the extent of the buyout amounts under the lease. The trial judge found that the breach of trust claim over the sale proceeds from unit 4 constituted a Post-Filing Claim that was not released by the Plan. The trial judge awarded Caterpillar damages in a sum equal to the buyout amount for unit 4. Counsel for 360 advised us that he did not have instructions to appeal that order, which appears to have a monetary value approximating $32,000.

74 However, the trial judge found that the breach of trust relating to the sale of units 7 and 8 was not a Post-Filing Claim. As such, it was compromised and released by the Plan. This finding hinged on the timing of the breach.

75 The trial judge found that the breach of trust occurred at one of two times: first, when 360 received the sale proceeds and deposited them into its account without remitting the buyout amounts to Caterpillar (9 May 2001); or second, when 360 could no longer use the sale proceeds to pay Caterpillar because 360 had used the funds for other purposes. The trial judge found that, under the second scenario, the breach occurred no later than 27 June 2001. The trial judge concluded that the breach did not occur when the bank account balance fell below the sale proceeds from units 7 and 8 (28 June 2001). Rather, it occurred when 360 made withdrawals or issued cheques on the account which resulted in the account entering an overdraft position. The cheques that were posted to the account on 28 June 2001 dated from 6 June 2001 to 25 June 2001. They were date-stamped by the drawee bank on 27 June 2001. The trial judge rejected Caterpillar's submission that 360's omission to place stop payments on the cheques constituted an independent breach of trust.

76 Caterpillar argues that the trial judge erred in finding that the only acts relevant to the breach occurred before the Filing Date (28 June 2001) and that the mere writing of a cheque would necessarily result in the payment of funds contrary to the trust. In furtherance of the latter assertion, Caterpillar maintains that it was open to 360 to issue a stop payment on the cheques or otherwise prevent the funds from being used prior to the Filing Date.

77 Both Caterpillar and 360 agree that the holding of funds without Caterpillar's authorization — specifically, 360's failure to remit the buyout amounts to Caterpillar — constitutes a breach of trust. 360 improperly treated the money as its own rather than that of Caterpillar's.

78 The crux of Caterpillar's argument is as follows. If the date of breach is 9 May 2001, Caterpillar's damages would be limited to the cost of wrongful holding; namely, interest or opportunity cost. Caterpillar acknowledges that a claim for those damages is compromised by the Plan.

79 However, Caterpillar emphasizes that its claim is for the entirety of the sale proceeds. It contends that only after the Filing Date (28 June 2001) did 360 render the sale proceeds unavailable to Caterpillar. Caterpillar identifies this later breach of trust as a Post-Filing Claim.

80 In my opinion, Caterpillar's arguments cannot succeed. Essentially, Caterpillar seeks to impose the date most favourable to its position in the *CCAA* reorganization. This is exemplified by the fact that Caterpillar concedes that 360's initial holding of the sale proceeds without remittance to Caterpillar constituted a breach of trust and yet it seeks to impose a subsequent (and in my opinion, completely uncertain) date for what it describes as a later breach of trust. In my view, this line of argument ignores the true nature of the breach. 360 was in breach from the moment it retained the sale proceeds without either remitting them to Caterpillar or Caterpillar's authorization. This breach continued until Caterpillar's claim was either satisfied or compromised by the Plan.

81 I agree with 360's submission that the *CCAA* does not accord a creditor wide discretion to characterize its claim as a means of elevating its status. Caterpillar, after acknowledging that there was a breach of trust prior to the Filing Date, cannot identify a post-Filing Date event — the actual withdrawal of trust funds — to convert its entire claim to a Post-Filing Claim.

82 In my view, it was the act of writing cheques and delivering them to the payee that constituted the breach of trust. That act is identifiable and unambiguous: it is the active commission of a wrongful act. In contrast, the date on which funds are withdrawn is uncertain: is it when the account is actually reduced by the amount of the trust funds or when the drawee bank irrevocably loses its right to return the cheque through the clearing process?

83 Wherever possible, the law should favour certainty. In my opinion, the trial judge did not err in fixing the date of the breach to be when the breach was being actively committed, as opposed to when it was allegedly being committed by omission.

Conclusion

84 For all of the above reasons, I would dismiss Caterpillar's appeal.

***Prowse J.A.*:**

I agree.

***Saunders J.A.*:**

I agree.

Appeal dismissed.

46

OPPRESSION

AND RELATED REMEDIES

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> action for damages, at applying *ex post facto* the universal solvent of a monetary award as compensation for some wrong which is no longer a continuing wrong.[4]

Both the over-riding purpose of ending oppression and the enumerated remedies can be seen as encouraging judicial interference in corporate affairs. The potentially intrusive nature of the remedy has been tempered by the principles of minimal interference and reasonable expectations. As their names suggest, these principles hold that courts should interfere as little as possible in corporate affairs and that the remedy ought to reflect the reasonable expectations of the parties.

The principle of minimal interference in corporate affairs has been articulated in various ways:

- Courts should interfere to the extent necessary to correct the matters complained of but no further.[5]
- "Surgery should be done with a scalpel and not with a battleaxe."[6]
- The object is not to punish but to apply a measure of corrective justice.[7]
- The job of the court is to even the balance not to tip it in favour of one party.[8]
- Courts prefer specific orders over more drastic orders.[9]

---

4 *Scottish Co-operative Wholesale Society Ltd. v. Meyer*, [1954] S.C. 381 (Scotland Ct. Sess.) at 388, Lord President Cooper, affirmed (1958), [1959] A.C. 324 (U.K. H.L.).

5 *Naneff v. Con-Crete Holdings Ltd.* (1995), 23 O.R. (3d) 481 at 488 (Ont. C.A.), Galligan J.A.; *820099 Ontario Inc. v. Harold E. Ballard Ltd.* (1991), 3 B.L.R. (2d) 123 at 181 (Ont. Gen. Div.), affirmed (1991), 3 B.L.R. (2d) 113 (Ont. Div. Ct.); *Tsui v. International Capital Corp.*, [1993] 4 W.W.R. 613 at 633 (Sask. Q.B.), affirmed (1993), 113 Sask. R. 3 (Sask. C.A.), Barclay J.; *Borsook v. Broder* (1994), 16 B.L.R. (2d) 265 (Ont. Gen. Div. [Commercial List]), Farley J.

6 *820099 Ontario Inc. v. Harold E. Ballard Ltd.* (1991), 3 B.L.R. (2d) 123 at 197 (Ont. Gen. Div.), affirmed (1991), 3 B.L.R. (2d) 113 (Ont. Div. Ct.).

7 *Naneff v. Con-Crete Holdings Ltd.* (1995), 23 O.R. (3d) 481 at 488 (Ont. C.A.), Galligan J.A.

8 *820099 Ontario Inc. v. Harold E. Ballard Ltd.* (1991), 3 B.L.R. (2d) 123 at 197 (Ont. Gen. Div.), affirmed (1991), 3 B.L.R. (2d) 113 (Ont. Div. Ct.). See also *Explo Syndicate v. Explo Inc.* (June 29, 1989), Doc. Niagara North 6007/87, [1989] O.J. No. 1494 (Ont. H.C.), Gravely L.J.S.C.; *Sabex Internationale Ltée, Re* (1979), 6 B.L.R. 65 at 91 (Que. S.C.), Gonthier J.

9 *Stapleton v. Fleming Feed Mill Ltd.* (2001), 18 B.L.R. (3d) 280 at 287 (Ont. S.C.J.), Gillese J.

- The remedy should be proportionate to the harm.[10]

Minimal interference can, however, backfire. In *Ferguson v. Imax Systems Corp.*,[11] the relationship between the parties had broken down. Instead of fashioning an exit remedy, the court enforced further co-habitation. This simply led to further litigation.[12] To address this concern, some courts have pointed out that remedies should be designed to reduce the possibility of future litigation.[13] To this end relief can be granted as an "interim order" even after a full hearing, thereby allowing the applicants to seek additional orders within the same proceeding should the oppression persist.[14] This suggests that courts might be willing to assume some limited form of on-going oversight if doing so permits them to make less intrusive orders.[15]

The desire to prevent future litigation can also lead to more intrusive remedies than those the applicant seeks if the court believes that the relief claimed will not end the oppression.[16] In *Wind Ridge Farms Ltd. v. Quadra Group Investments Ltd.*,[17] the complainant asked the court to set aside corporate resolutions that changed the rights associated with its shares. The Saskatchewan Court of Appeal found that this was an inadequate remedy and required the respondents to purchase the complainant's shares at fair value even though the complainant wanted to retain its shares if they could not be purchased at a price satisfactory to it.[18] These more intrusive remedies are nevertheless consistent with the principle of minimal interference. Minimal interference simply calls for the least intrusive order that would end the state of oppression. If the applicant's remedy will not, in the court's view, end the oppression, then a

10 *Stapleton v. Fleming Feed Mill Ltd.* (2001), 18 B.L.R. (3d) 280 at 298 (Ont. S.C.), Gillese J.

11 (1983), 43 O.R. (2d) 128 (Ont. C.A.), leave to appeal refused (1983), 52 N.R. 317 (note) (S.C.C.).

12 See *Ferguson v. Imax Systems Corp.* (1984), 47 O.R. (2d) 225 (Ont. Div. Ct.), Southey J.

13 *Peterson v. Kanata Investments Ltd.* (1975), 60 D.L.R. (3d) 527 at 544 (B.C. S.C.), Toy J.

14 *Low v. Ascot Jockey Club Ltd.* (1986), 1 B.C.L.R. (2d) 123 at 131-132 (B.C. S.C.), Southin J.

15 *Sparling c. Javelin International Ltée*, [1986] R.J.Q. 1073 at 1077 (Que. S.C.), varied on another point (1987), 19 Q.A.C. 4 (Que. C.A.), leave to appeal refused (1992), 53 Q.A.C. 169 (note) (S.C.C.); *Low v. Ascott Jockey Club Ltd.* (1986), 1 B.C.L.R. (2d) 123 (B.C. S.C.), Southin J.

16 *Chicago Blower Corp. v. 141209 Canada Ltd.* (1988), 40 B.L.R. 201 at 210 (Man. Q.B.); *Tsui v. International Capital Corp.*, [1993] 4 W.W.R. 613 at 633 (Sask. Q.B.), affirmed (1993), 113 Sask. R. 3 (Sask. C.A.), Barclay J.; *Classic Organ Co. v. Artisan Organ Ltd.* (1997), 35 B.L.R. (2d) 285 (Ont. Gen. Div.); *Wind Ridge Farms Ltd. v. Quadra Group Investments Ltd.* (1999), 50 B.L.R. (2d) 1 (Sask. C.A.), Vancise J.A.

17 (1999), 50 B.L.R. (2d) 1 at 20 (Sask. C.A.), Vancise J.A.

18 *Wind Ridge Farms Ltd. v. Quadra Group Investments Ltd.* (1999), 50 B.L.R. (2d) 1 at 16, 21 (Sask. C.A.), Vancise J.A.

47

THE PRINCIPLES OF
EQUITABLE REMEDIES

SPECIFIC PERFORMANCE,
INJUNCTIONS, RECTIFICATION
AND
EQUITABLE DAMAGES

BY

I. C. F. SPRY, LL.D.

One of Her Majesty's Counsel

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applied here likewise, and generally they require specific enforcement of the subsequent inconsistent contract to be refused.[3] Indeed, where necessary an injunction may be granted restraining the proposed breach.[4]

The second and more difficult case occurs where the contract with a third person is valid at law but is such that its obligations will not be enforced in equity by injunction or specific performance or any other such equitable remedy. Here whether an inconsistent contract that is otherwise specifically enforceable should or should not be enforced depends on more general considerations, such as questions of fairness and of hardship to the defendant or to the third person, and the order in which the two contracts were entered into may be decisive. For as will be seen, when the court is determining whether specific performance should be granted it takes into account whether or not enforcement may impose hardship or inconvenience on persons other than the defendant, although this is a consideration the weight of which varies considerably according to the other circumstances in question.[5] Accordingly the court regards as relevant the precise probability that specific performance will involve a breach of contract with a third person and may, on discretionary grounds, decline to make an order that has this effect,[6] although there often are found countervailing considerations that are of sufficient weight to render the grant of specific performance just. Here account is taken in particular of any ground for diminishing the weight to be given to the claims of those concerned, such as laches or acquiescence.[7]

If, should specific performance be ordered, the person in breach of a contract with a third person would be the plaintiff, rather than the defendant, the principles that have been set out here are affected by the fact that such discretionary matters as consequent prejudice or hardship apply differently, since the plaintiff rather than the defendant is responsible for the inconsistency.

[3] In *Manchester Ship Canal Co. v. Manchester Racecourse Co.* [1901] 2 Ch. 37, a right to an injunction arose under the earlier contract on the doctrine of *Lumley v. Wagner.* See also *Weatherall v. Geering* (1806) 12 Ves. 504, 33 E.R. 191, *Willmott v. Barber* (1880) 15 Ch. D. 96, *Erskine McDonald Ltd. v. Eyles* [1921] 1 Ch. 631, *Sefton v. Tophams Ltd.* [1965] Ch. 1140 at pp. 1206-1209 and *Harvela Investments Ltd. v. Royal Trust Co. of Canada (C.I.) Ltd.* [1985] Ch. 103 at p. 122. Compare the somewhat different position that arose in *Hogan v. Regional Centres Pty. Ltd.* (1963) 81 W.N. (N.S.W.) 59.

[4] *Manchester Ship Canal Co. v. Manchester Racecourse Co.* [1901] 2 Ch. 37; *Sefton v. Tophams Ltd.* [1965] Ch. 1140.

[5] See pp. 201-203, infra. Note especially *Hounslow London Borough Council v. Twickenham Garden Developments Ltd.* [1971] Ch. 233 and *Miller v. Jackson* [1977] Q.B. 966.

[6] *Warmington v. Miller* [1973] Q.B. 877.

[7] See pp. 225-244, infra.

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Injunctions and Specific Performance

LOOSELEAF EDITION

The Honourable

Mr. Justice Robert J. Sharpe

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CHAPTER 1

GENERAL PRINCIPLES

1. Forms of Injunctive Relief

(1) Mandatory injunctions

A mandatory injunction is one which requires the defendant to act positively.[1] A mandatory injunction may be given to remedy past wrongs and require the defendant to undo some wrong he or she has committed. Such orders are restorative in nature, requiring the defendant to take whatever steps are necessary to repair the situation in a manner consistent with the plaintiff's rights.[2] In other cases, mandatory injunctions look to the future and require the defendant to carry out some unperformed duty to act.[2a] In either class of case, although the general principles governing the availability of injunctive relief apply, the very fact of requiring a positive course of action raises special problems.[3] 1.10

(2) Prohibitive injunctions

The most common form of injunction is the prohibitive order which restrains the defendant from committing a specified act. At the heart of the injunctive process is the prohibition, permanently or temporarily, of wrongful conduct or conduct which would interfere with the rights of another.[4] Prohibitive injunctions are the subject of most of Part I of this book, and the particular problems of appropriateness, definition and enforceability are dealt with in the pages which follow. Prohibitive injunctions are also frequently 1.20

1 *D. (P.) v. British Columbia* (2010), 7 B.C.L.R. (5th) 312, 82 R.F.L. (6th) 180 (S.C.), citing this passage at para. 141.

2 *Lomas v. Rio Algom Ltd.* (2010), 316 D.L.R. (4th) 385, 99 O.R. (3d) 161 (C.A.), citing this passage with approval at para. 85.

2a See *1711811 Ontario Ltd. v. Buckley Insurance Brokers Ltd.* (2014), 371 D.L.R. (4th) 643, 315 O.A.C. 160 (Ont. C.A.), citing this paragraph at para. 57.

3 See, *infra*, 1.500 *et seq; Bark & Fitz Inc. v. 2139138 Ontario Inc.* (2010), 186 A.C.W.S. (3d) 687, 2010 ONSC 1793, leave to appeal refused 188 A.C.W.S. (3d) 1019 (S.C.J. (Div. Ct.)) citing this para. and paras. 1-20 and 1-30 with approval at para. 7.

4 *149227 Canada Inc. v. Royal Trust Co.* (1997), 154 Nfld. & P.E.I.R. 334 at p. 343 (Nfld. S.C.); *Drader v. Abbotsford (City)* (2012), 98 M.P.L.R. (4th) 216, 22 R.P.R. (5th) 179 (B.C.S.C.), citing this passage at para. 413, affd 586 W.A.C. 237, 48 B.C.L.R. (5th) 92 (B.C.C.A.).

2. Inadequacy of Damages

(1) Historical factors

1.60 The traditional rule is that an injunction will be granted only where damages would provide an inadequate remedy.[9] The reason for this is largely historical. Injunctions are an equitable remedy and the pre-Judicature Act dual-court structure imposed limitations on equitable jurisdiction. While the "common" injunction was used as a potent device to force parties in common law actions to abide by equitable principles,[10] common law remedies remained predominant and the specific remedies of injunction and specific performance were limited to those special circumstances where the common law remedy of damages was seen to be inadequate. Law and equity have been fused and a single court now administers both, but the imprint of history has not been erased.[11]

1.70 It is not possible to define inadequacy of damages in a precise way. It is a vague principle which takes shape depending upon the context. It means one thing when used with respect to interlocutory injunctions,[12] another in nuisance actions[13] and still another where an injunction is sought to restrain a breach of contract.[14]

1.80 Indeed, as seen in Chapters 4 and 9 respectively, where injunctions are sought to restrain interference with property rights or to restrain breach of negative covenants, injunctions are in fact so strongly favoured that it is more accurate to say that the injunction is the presumed remedy.[15] Because the phrase "inadequacy of damages" has varying meaning in varying contexts, detailed discussion of its effect is best postponed and presented in the various chapters dealing with these particular applications of specific relief.

1.90 It can be argued that the historical rationale for the inadequacy of damages principle, to the extent that it implies a presumption in favour of one remedy or another, has long since disappeared and that

9 See, *e.g.*, *London & Blackwall Ry. Co. v. Cross* (1886), 31 Ch. D. 354 (C.A.), at p. 369, *per* Lindley L.J.: "The very first principle of injunction law is that *prima facie* you do not obtain injunctions to restrain actionable wrongs, for which damages are the proper remedy."

10 See Eden, *Law of Injunctions* (London, Butterworth & Son, 1821).

11 For a detailed examination, see Perell, *The Fusion of Law and Equity* (Toronto, Butterworths, 1990); Mason, "The Place of Equity and Equitable Remedies in the Contemporary Common Law World" (1994), 110 L.Q.R. 238. See also, *infra*, footnote 274 and 10.10.

12 *Infra*, 2.390 to 2.520.

13 *Infra*, Chapter 3.

14 *Infra*, Chapter 9.

15 *McDonald's Restaurants of Canada Ltd. v. West Edmonton Mall Ltd.*, [1994] 10 W.W.R. 662, 159 A.R. 120 (Q.B.); *Certicom Corp. v. Research in Motion Ltd.* (2009), 94 O.R. (3d) 511, 71 C.P.R. (4th) 278 (S.C.J.).

each cause of action that accrues. The effect of an injunction is to stop the wrongful conduct entirely and thereby avoid the need for a succession of actions for retrospective damages.[56] Although specific mention is not often made in modern cases of this rationale for injunctive relief, it remains an important consideration.

1.250 It should be noted, however, that the objective of avoiding a multiplicity of suits can be met without awarding an injunction. Courts do have the power to award "damages in lieu of an injunction" compensating the plaintiff for prospective wrongs.[57] Such awards are discussed in the companion volume to this book[58] and are also discussed in various parts of this book as an alternative to an injunction.[59] As such awards are possible, the possibility of multiplicity of suits for future wrongs does not necessarily lead to the conclusion that an injunction should be ordered.

3. Supervision

(1) Continuing judicial direction

1.260 It is often said that where the obligation of the defendant requires performance of an ongoing or complex nature, the court will not grant an injunction, thereby undertaking the task of supervision.

1.270 The difficulty of supervision and the court's reluctance to make an order which will require further judicial direction or intervention is a familiar theme, especially in mandatory injunction cases. In an early Ontario case where the Attorney-General sought a mandatory injunction to require the repair of certain roads, Blake C. held that:

> To admit such a jurisdiction would be, in effect, to constitute this court the general superintendent of roads throughout the province; for, if it be our duty to direct the defendants to repair this particular highway, it must be equally our duty to grant relief in every other case of neglect — which is, I think, absurd.[60]

1.280 Similarly, in *Powell Duffryn Steam Coal Co. v. Taff Vale Ry. Co.*[61] the plaintiff was held entitled to run its trains over part of the defendant's line but none the less was refused a mandatory injunction on the grounds that:

56 An injunction that deals with prospective damages does not amount to an election that precludes a claim for past damages: *Ragdoll Productions (UK) Ltd. v. Jane Doe* (2002), 21 C.P.R. (4th) 213, [2003] 2 F.C. 120 (F.C.T.D.).

57 *Supra*, 1.190 to 1.220.

58 Waddams, *op. cit.*, footnote 42, 13.510 to 13.540.

59 See, *e.g.*, *supra*, 1.190 to 1.220; *infra*, 4.30 to 4.50.

60 *A.-G. v. Weston Plank Road Co.* (1853), 4 Gr. 211 (C.A.), at p. 218. For a more modern statement, see *McKenzie Barge & Marine Ways Ltd. v. District of North Vancouver* (1964), 44 D.L.R. (2d) 382, 47 W.W.R. 30 (B.C.C.A.).

61 (1874), 9 Ch. App. 331.