Court File No. CV-16-11257-00CL

ONTARIO
SUPERIOR COURT OF JUSTICE
COMMERCIAL LIST

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 PT HOLDCO, INC., PRIMUS TELECOMMUNICATIONS CANADA, INC., PTUS, INC., PRIMUS TELECOMMUNICATIONS, INC., AND LINGO, INC.

APPLICATION UNDER THE *COMPANIES' CREDITORS ARRANGEMENT ACT*, R.S.C. 1985, c. C-36, AS AMENDED

APPLICANTS' RESPONDING BOOK OF AUTHORITIES
(Returnable August 9, 2016)

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28.	Angela Swan, *Canadian Contract Law*, 3rd Ed. (Markham: LexisNexis, 2012)
29.	Janis P. Sarra and Justice Georgina R. Jackson, *"Selecting the Judicial Tool To Get The Job Done: An Examination of Statutory Interpretation, Discretionary Power and Inherent Jurisdiction in Insolvency Matters"* (2008) Ann Rev Insol L 55

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AND IN THE MATTER OF THE WINDING-UP AND RESTRUCTURING ACT, R.S.C. 1985, c. W.10, as amended

AND IN THE MATTER OF THE WINDING-UP OF SHOPPERS TRUST COMPANY

DELOITTE & TOUCHE INC., Liquidator of Shoppers Trust Corporation appointed pursuant to the Winding-up and Restructuring Act, R.S.C. 1985, c. W.11 (Applicant / Respondent in Appeal) and SHOPPERS TRUST COMPANY (Respondent)

Moldaver, Blair, LaForme JJ.A.

Heard: January 26, 2005
Judgment: March 24, 2005
Docket: CA C41924

Proceedings: reversing *Shoppers Trust Co. (Liquidator of) v. Shoppers Trust Co.* (2004), 2004 CarswellOnt 358, 3 C.B.R. (5th) 155 (Ont. S.C.J.)

Counsel: Jeffrey Leon, Edmund Lamek for Appellant, Canada Deposit Insurance Company
John B. Laskin, Cynthia Tape for Respondent, Phillip Daniels

Subject: Corporate and Commercial; Insolvency

Headnote

Business associations --- Changes to corporate status — Winding-up — Under Dominion Act — Claims of creditors — Miscellaneous issues

Superintendent of Deposit Institutions took control of assets of insolvent trust company in 1992 — Winding-up order had deemed commencement date in 1992 — Date for interest payable on outstanding claims was set at April 24, 1992 — Remaining assets at end of 2002 surpassed $40,000,000 — Surplus of $6,000,000 available for distribution to subordinated debenture holders — Other creditors wanted interest payment date changed to winding-up date — Changing date would result in absorption of surplus by other creditors — Liquidator's motion for directions resulted in finding that funds were to be distributed in accordance with prior order — Trial judge found no basis for changing interest payment date — Trial judge found fact that winding-up date was normally used as cut-off date for interest on claims was not sufficient for changing order — Trial judge found statute did not require winding-up date to be interest payment date, and date had been selected carefully — Trial judge found liquidator reserved right to seek variation of interest payment date if surplus arose, but variation would be unfair because of effect on subordinated debenture holders — Liquidator appealed — Appeal allowed — Trial judge erred in finding that proceedings were motion to vary — Winding-up and Restructuring Act provides that claims against insolvent estate are calculated at date of winding-up — Trial judge erred in finding that creditors' rights to claim principal plus interest to date of winding-up was standard practice, rather than one of insolvency law — Liquidation

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APPEAL by liquidator from judgment reported at *Shoppers Trust Co. (Liquidator of) v. Shoppers Trust Co.* (2004), 2004 CarswellOnt 358, 3 C.B.R. (5th) 155 (Ont. S.C.J.), determining date of calculating interest on debts of corporation subject to winding-up proceedings.

***Blair J.A.*:**

Background

1 Shoppers Trust Corporation was a loan and trust company, incorporated under the Ontario *Loan and Trust Corporations Act*.[1] It invested in mortgages, held and leased commercial real estate properties, and administered a portfolio of mortgage-backed securities. By 1992, it was the second-largest enterprise of its kind in Canada.

2 Like many enterprises with a focus on real estate, however, Shoppers fell into financial difficulties in the early 1990's. On March 6, 1992, the Ontario Superintendent of Deposit Institutions took possession and control of its assets and it was shortly ordered to be wound up under the Ontario *Corporations Act*.[2] When investigations confirmed that Shoppers Trust was insolvent, the Liquidator applied for an order under the federal winding-up legislation. On August 19, 1992, Mr. Justice Houlden granted an order under the *Winding-up Act*, now the *Winding-up and Restructuring Act*,[3] directing that the Corporation be liquidated, with an effective winding-up date of July 31, 1992.

3 At the time of these events, everyone believed there would be insufficient funds from the liquidation of the assets of the Corporation to satisfy in full the claims of depositors, the Crown, and secured and unsecured creditors. That belief has turned out to be somewhat pessimistic, however. Because of various delays in the administration of the estate — the reasons for which are not pertinent to this appeal — a significant amount of interest has accumulated on the liquidated assets. The Liquidator finds itself with unanticipated extra funds of approximately $6 million available for distribution.

4 At issue on this appeal is who is entitled to receive those funds.

5 The appellant, Canada Deposit Insurance Corporation ("CDIC") — which is subrogated to the rights of insured depositors whose claims it has paid — asserts that the extra funds should be disbursed to the deposit creditors and ordinary creditors of the Corporation to the extent there is unpaid principal and unpaid interest outstanding to the date of the winding-up. The respondent, Mr. Daniels, submits that the additional monies should be paid towards the principal outstanding on the sub debt held by him and other members of his family, notwithstanding that the claims of the subordinate noteholders rank behind the claims of all other creditors in the insolvency. Mr. Daniels makes this submission on the strength of an order made by Justice Houlden on March 10, 1993, authorizing and directing the Liquidator to calculate interest due on provable claims to April 24, 1992 (approximately three months before the effective winding-up date of July 31, 1992, set out in his earlier order of August 19, 1992).

6 In January 2004, the Liquidator applied to Justice Ground for directions regarding the distribution of the extra funds. Treating the motion as in substance a motion to vary the March 10, 1993 order of Justice Houlden, the motion judge declined to do so, and ruled in favour of Mr. Daniels. It is that order which is under appeal.

7 Respectfully, in my view, Ground J. erred, and I would allow the appeal, for the reasons that follow.

Facts

The Claimants and the Scheme of Distribution

8 The respondent held 75% of the shares of Shoppers; his brother, John Daniels, the remaining 25%. These shares were held either directly or indirectly through family members and related corporations. The Daniels were issued subordinated notes by the corporation in exchange for advances totalling approximately $8 million. It is not disputed that this is a legitimate corporate debt. However, the notes specifically provide that the indebtedness evidenced by them "is subordinated in right of payment to all other indebtedness of the corporation".

9 Because of the obligation of a loan and trust corporation to keep certain of its assets segregated as security for the monies placed with it on deposit, the assets of Shoppers are divided into two categories for purposes of its liquidation, namely, a Guaranteed Fund and a Company Fund. The Guaranteed Fund consists of monies held for the benefit of the corporation's depositors. The Company Fund consists of all other company assets and is subject to the claims of the

Deposit Creditors (to the extent they are not satisfied from the Guaranteed Fund), the Crown, secured and unsecured creditors, and the subordinated noteholders.

10 In the liquidation, the administration of the Guaranteed Fund is substantially completed, and a final distribution was made from that fund in April 2000. The distribution was insufficient to satisfy the claims of the Deposit Creditors in full, leaving them with a shortfall claim ("the Shortfall Claim") against the Company Fund for $40,250,000, based on provable claims for principal as at July 31, 1992 (the date of the winding-up), with interest calculated as at April 24, 1992, pursuant to the order of March 10, 1993, referred to above.

11 The Deposit Creditors consist of CDIC and a group of depositors whose claims exceed $60,000. CDIC is by far the largest claimant. It acquired that position in its subrogated capacity, having reimbursed the corporation's depositors — up to $60,000 each — in accordance with its guarantee obligations under the *Loan and Trust Corporations Act*. On April 24, 1992, CDIC paid a total of approximately $491.5 million to depositors, representing the insured portion of their claims. Its subrogated interest represents 99% of the claims against the Shoppers Trust estate. In addition to CDIC's subrogated claim, a number of depositors whose claims exceeded the $60,000, also maintain claims in their own right for that excess. These uninsured depositor claims total approximately $5 million.

12 Shoppers had trade creditors and other unsecured creditors (together, the "Ordinary Creditors") with claims totalling about $1.2 million. The claims of the Crown and of the secured creditors are not pertinent to the issues on this appeal.

13 As at December 31, 2002, the Liquidator had funds of $47,283,000 for distribution from the Company Fund. This constitutes an excess of approximately $6 million over the amounts necessary to pay the claims of the Deposit Creditors and the Ordinary Creditors, with interest calculated to April 24, 1992, in accordance with the March 10, 1992 order. The effect of calculating the quantum of those claims based on interest to the date of the winding-up is to eliminate the $6 million excess referred to above. The following chart illustrates this outcome:

	April 24, 1992	**July 31, 1992**
Guaranteed Fund Shortfall Claimants	$ 40,250,000	$ 53,636,000
Trade Creditors	$ 565,000	$ 577,000
Other ordinary Creditors	$ 555,000	555,000
Subtotal:	$ 41,370,000	$ 54,768,000
Total Amount Available for Distribution	$ 47,283,000	$ 47,283,000
Less Claims by Shortfall Claimants and Other Unsecured Creditors:	$ 41,370,000	$ 54,768,000
Balance Available for Distribution	$ 5,913,000	0

The March 10, 1993 Order and the Interest Calculation Date

14 The March 10, 1993 order of Justice Houlden fixing an interest calculation date of April 24, 1992 was made — on the recommendation of the Liquidator and with the support of CDIC — for practical reasons. At the time, no one thought there would be sufficient funds in the insolvent estate to satisfy the claims of the Deposit Creditors and the Ordinary Creditors for principal and interest to the date of the winding-up. CDIC had made its payment to depositors based upon an interest calculation it had already done as at April 24, 1992. It was not worth the expense of re-calculating the interest amounts as at July 31 because doing so would not change the proportionate amounts that claimants would receive and the cost of the exercise would diminish the funds available for distribution.

15 In support of the motion leading to the March 10, 1993 order, the Liquidator filed a memorandum — as Liquidators normally do in the course of such proceedings — reporting on the status of the liquidation to that point and making various recommendations. At paragraphs 91 and 92 of the memorandum, the Liquidator said:

91. The major creditor claiming against the Company Fund is CDIC as to 98% in Proposal One and as to 97% in Proposal Two.[4] Again, CDIC has agreed to accept April 24, 1992 as the interest calculation date for the purposes of any distribution of the proceeds of assets in the Company Fund.

92. If there is a surplus after all other claims on the Company Fund have been satisfied, then claims for interest accruing to July 31, 1992 will be considered. The Liquidator expects a recovery for unsecured creditors on the Company Fund assets of only 46% under Proposal One and no recovery under Proposal Two and therefore does not expect there to be any surplus.

16 The motion judge accepted the respondent's argument that the Liquidator had in effect committed that it would not seek to pay interest to the Deposit Creditors and Ordinary Creditors to the date of the winding-up, unless there was "a surplus after *all other claims* on the Company Fund" had been satisfied [emphasis added]. He concluded that there was no such "surplus" on the facts before him because the words "all other claims" must include the subordinated debt, and no amounts had yet been paid on those claims. Accordingly, he ruled that the March 10, 1993 order should not be "varied".

Analysis

17 On behalf of the respondent, Mr. Laskin argues that the motion judge — an experienced commercial list judge responsible for supervising the liquidation of Shoppers Trust — exercised a discretion based on findings of fact and decided in the circumstances not to vary the earlier order of Justice Houlden. He submits that the judge's exercise of discretion is entitled to deference and that the appeal should be dismissed.

18 In my view, however, the directions the motion judge was called upon to provide did not entail the exercise of discretion at all. Instead, he was required to determine whether, as a matter of law, the Deposit Creditors and Ordinary Creditors were entitled to prove their claims, including any interest component of those claims, to the date of the winding-up, and, if so, whether the terms of the March 10, 1993 order precluded them from doing so in priority to the claims of the subordinated noteholders. The motion judge failed to address his mind to these questions and, in my respectful opinion, this led him astray in three respects and resulted in a decision that must be set aside.

19 First, the motion judge erred in treating the proceeding before him as a motion to vary, governed by the provisions of rule 59.06 of the *Rules of Civil Procedure*, rather than approaching it as the motion for directions in the liquidation proceedings that it was. Secondly, and most significantly, he was mistaken in viewing the right of a creditor to claim the full amount of principal plus interest due and owing to the date of the winding-up as a "usual practice" rather than as the governing principle of insolvency law that it is. Finally, he misconceived the effect of the memorandum filed by the Liquidator at the time of the motion before Justice Houlden; he placed too much emphasis on and misconstrued its wording; and, as a result, he failed to give effect to the fundamental principle of *pari passu* distribution underlying insolvency law.

Motion for Directions

20 The motions judge was not faced with a motion to vary the March 10, 1993 order of Justice Houlden. He was faced with a motion by the Liquidator for directions as to how the unanticipated extra funds in the estate should be distributed in the circumstances. While the incidental effect of an order for directions in an insolvency proceeding might be to alter or vary a previous order made during the course of supervision of the proceedings, such a motion for directions is not governed by the same principles that apply to rule 59.06 motions to vary, in my opinion.

21 The basis upon which an order may be set aside or varied under that rule is restricted to situations involving fraud or facts arising or discovered after the original order was made. Courts have traditionally taken a narrow approach to granting such relief. Where the ground asserted is that of fresh evidence or a change in circumstances -the approach taken by the motion judge here — the moving party must show that the new evidence (a) could not have been obtained through

reasonable diligence prior to the order being made, (b) is apparently credible and (c) would probably have affected the outcome of the earlier hearing.

22 Such an approach is inapposite to a motion for directions in a winding-up proceeding, where the emphasis is not so much on whether the subsequent change in circumstances would have affected the original order made, but rather is on what order should be made in the present circumstances based upon the governing legal principles, the objectives of the winding-up regime, and what is fair and reasonable in the circumstances. A motion for directions may or may not involve an exercise of discretion by the motion judge. In this case, it did not.

The Law Respecting the Payment of Interest in Winding-up Proceedings

23 At para. 37 of his reasons, the motion judge said:

> I am not satisfied that the fact that claims of creditors in a liquidation normally include interest up to the Winding-Up Date is a basis for the court, in this case, exercising its jurisdiction to vary the Houlden Order. There was no provision in the *WUA* [5] applicable at the date of the Houlden Order providing that claims were to be calculated as of the Winding-Up Date and interest payable up to the Winding-Up Date. The fact that that appears to have been the usual practice in liquidations at that time does not, in my view, override a specific provision of a judicial order that a different calculation date apply [*sic*] and a direction to calculate claims as of that date.

24 Respectfully, the motion judge erred in concluding that a creditor's right to claim principal plus interest due to the date of the winding-up was simply "the usual practice" in liquidation matters. The creditor's right in that regard was not a matter of practice; it was, and remains, a matter of insolvency law. As Selwyn L.J. stated in *Humber Ironworks & Shipbuilding Co., Re* (1869), 4 Ch. App. 643 (Eng. Ch. Div.), at 646-647:

> Now, it has been very properly admitted, on the part of the Appellant, that there can be no question as to any interest due at the time of the winding-up . . . because [the creditor's] interest due at the date of the winding-up is just as much a debt as the principal. . . . I think the tree must lie as it falls; that it must be ascertained what are the debts as they exist at the date of the winding-up, and that all dividends in the case of an insolvent estate must be declared in respect of the debts so ascertained.

25 The rationale underlying this approach rests on a fundamental principle of insolvency law, namely, that "in the case of an insolvent estate, all the money being realized as speedily as possible, should be applied equally and rateably in payment of the debts as they existed at the date of the winding-up": *Humber Ironworks*, at 646. Unless this is the case, the principle of *pari passu* distribution cannot be honoured. See also *McDougall, Re* (1883), 8 O.A.R. 309 at paras. 13-15, ; *Principal Savings & Trust Co. v. Principal Group Ltd. (Trustee of)* (1993), 109 D.L.R. (4th) 390 (Alta. C.A.) at paras. 12-16; and *Canada (Attorney General) v. Confederation Trust Co.* (2003), 65 O.R. (3d) 519, [2003] O.J. No. 2754 (Ont. S.C.J.), at 525 [O.R.]. While these cases were decided in the context of what is known as the "interest stops" rule [6], they are all premised on the common law understanding that claims for principal and interest are provable in liquidation proceedings to the date of the winding-up.

26 Thus, it was of little moment that the provisions of the *Winding-up* Act in force at the time of the March 10, 1993 order did not contain any such term. The 1996 amendment to s. 71(1) of the *Winding-up and Restructuring Act*, establishing that claims against the insolvent estate are to be calculated as at the date of the winding-up, merely clarified and codified the position as it already existed in insolvency law. Any debate in the earlier authorities concerned the appropriate choice of an effective date for the winding-up. Should it be the date of presentation of the petition, or the date the winding-up order is actually made? There was never a debate over the right of creditors to prove their claims in full, including any interest component, as of that effective date, whatever it may be. [7]

27 In giving the directions sought, in light of the unanticipated extra funds available to the Liquidator for distribution, the motion judge was obliged to give effect to the operative legal principles. His conclusion that the provisions of an order

made ten years earlier in the liquidation proceeding "trumped" the governing principles of law at the time of the motion for directions — particularly where circumstances had evolved that no one envisioned at the time — constituted an error in principle. The law was, and continues to be, that claimants are entitled to prove their claims for principal and interest to the date of the winding-up. The law also was — and the terms of the respondent's contract expressly provide — that the claims of subordinate noteholders are subsidiary to all other claims in the insolvency. The respondent subordinated noteholder is not entitled to recover any of his principal or interest until those other claims have been paid in full.

28 Finally, in this regard, I note that Justice Houlden did not purport to alter the date for proving claims in the liquidation by his order of March 10, 1993, although his earlier order of August 19, 1992, providing for the liquidation of Shoppers Trust, had specifically provided for a winding-up date of July 31, 1992. The order provided only for an earlier date for calculation of interest, based upon the practical considerations outlined above. Had such an experienced insolvency judge as Justice Houlden intended to alter a date as fundamental as the effective date of the winding-up — and, therefore, the date for the proving of claims — for all purposes of the liquidation, regardless of subsequent developments, I would have expected him to say so specifically. He did not.

29 I therefore conclude that the March 10, 1993 order was not intended to, and did not, set a proof of claims date which precluded creditors from proving their claims in full up to the winding-up date. To interpret the order otherwise would be to prevent creditors with interest-bearing claims from proving their full entitlement to pre-winding-up interest and to benefit the subordinate noteholders (whose claims are inferior to all other claims) unfairly, thus contravening the *para passu* principle that is fundamental to insolvency law. Accordingly, the order does not operate as a bar, trumping the rights of the Deposit Creditors and the Ordinary Creditors to be paid out of the unanticipated extra funds in priority to the subordinated noteholders.

The Liquidator's Memorandum

30 The motion judge's third error in principle also flowed from his approaching the proceedings as a motion to vary. He placed unwarranted emphasis on the wording of the memorandum filed by the Liquidator in support of the motion before Justice Houlden. Further, he mistakenly treated the memorandum as if it were, in effect, an agreement precluding the Liquidator from later proposing a scheme of distribution, which did not comply with his interpretation of para. 92, regardless of the funds subsequently available and regardless of the priorities and legal principles governing that distribution.

31 In considering whether the change in circumstances justified a variation of the March 10, 1993 order, he focussed on whether the unanticipated extra funds constituted a "surplus" within the meaning para. 92 of the memorandum. He concluded there was no surplus in that sense because "all other claims" against the Company Fund — that is, the claims of the subordinated noteholders — had not yet been paid. Because he viewed the memorandum as a binding commitment on the part of the Liquidator not to seek to vary the order unless there was such a surplus, he decided that he should not exercise his discretion to vary the order in the circumstances.

32 I see two problems with this approach.

33 First, I do not read the memorandum to be anything other than what it purported to be, namely, a report by the Liquidator recommending a practical solution for the distribution of funds and the calculation of interest, based upon the then existing circumstances. I do not think it can reasonably be interpreted as a covenant on the part of the Liquidator — and inferentially by CDIC — to support a later distribution of then unanticipated extra funds in a fashion that contravenes both the legal principles governing provable claims and the premise of *pari passu* distribution that underlies insolvency proceedings. As an officer of the court responsible for the liquidation of the assets of Shoppers, the Liquidator could not make such a commitment without court approval, and, as I have noted above, if Justice Houlden had intended the order of March 10, 1993, to have had such an effect, he would have said so in it.

34 Secondly, and in any event, while a literal reading of the words "all other claims against the Company Fund" in para. 92 of the memorandum might support the inclusion of the claims of subordinated noteholders, such an interpretation is inconsistent with the language of the paragraph as a whole, and makes no practical sense in the context of the proposed procedure for distribution of the Guaranteed Fund and the Company Fund that was being put forward.

35 Deposit Creditors have resort to the Guaranteed Fund. Their claims were not to be satisfied under either suggested proposal for distribution from the Guaranteed Fund, and the Deposit Creditors were therefore entitled to claim - *pari passu* with other unsecured creditors — against the Company Fund (the Shortfall Claims). Paragraph 91 of the memorandum notes that CDIC is the major creditor claiming against the Company Fund. Paragraph 92 then provides that "if there is a surplus after all other claims on the Company Fund have been satisfied, then claims for interest accruing to July 31, 1992 will be considered". That the reference to "all other claims" was intended to refer to the claims of all other *unsecured creditors* (i.e., the uninsured deposit creditors, the trade creditors and the other ordinary creditors) and not the subordinated noteholders, is apparent from the next sentence in para. 92, which states that "the Liquidator expects a recovery *for unsecured creditors* on the Company Fund assets of only 46% under Proposal One and no recovery under Proposal Two and therefore does not expect there to be any surplus" [emphasis added]. The subordinated noteholders are not unsecured creditors. The reality of the context in which the memorandum was drafted is that no one contemplated the chance of any recovery whatsoever for the subordinated noteholders. I conclude the Liquidator did not intend to include them in the reference to "all other claims against the Company Fund" in para. 92 of the memorandum.

36 In my view, therefore, there was a "surplus" as envisaged by para. 92 of the memorandum in the circumstances presented to the motion judge. The directions the Liquidator and CDIC were seeking from him were perfectly consistent with the Liquidator's recommendations in March 1993.

Disposition

37 I therefore conclude that the appeal should be allowed, the order of Ground J. set aside, and in its place an order granted:

> (a) authorizing the Liquidator to calculate the claims of (i) the Deposit Creditors who have Shortfall Claims, and (ii) the ordinary unsecured creditors, all of whom have claims against the Company Fund, including the interest component of such claims, as at the winding-up date of July 31, 1992 (the "Winding-up Date") and to admit such claims as of the Winding-up Date;
>
> (b) authorizing the Liquidator to use an estimated average annual rate of interest in order to calculate the accrued interest component of the claims of depositors attributable to the period from April 24, 1992 to the Winding-up Date; and,
>
> (c) authorizing the Liquidator to use the contractual rates of interest, if any, in order to calculate the accrued interest component of the claims of the other ordinary unsecured creditors of Shoppers attributable to the period from April 24, 1992 to the Winding-up Date.

38 Counsel have agreed that, whatever the outcome of the appeal, there should be no order as to costs.

Moldaver J.A.:

I agree.

Laforme J.A.:

I agree.

Appeal allowed.

Footnotes

1 R.S.O. 1990, c. L-25.

2 R.S.O. 1990, c. C-38.

3 R.S.C. 1985, c.W-11, as amended.

4 The memorandum contained two proposals for the allocation of assets between trust claimants and ordinary creditors.

5 The *Winding-up Act* R.S.C. 1985, c. W-11.

6 At common law, interest on provable claims stops as at the commencement of the winding-up. No interest is payable on claims from that date forward, unless there is a surplus in the estate. In the event of a surplus, post-liquidation interest is payable first on debts in respect of which there is a right to interest prior to the liquidation date. See *Canada (Attorney General) v. Confederation Trust Co.*, *supra*, at para. 21.

7 Section 5 of the *Winding-up and Restructuring Act* R.S.C. 1985, c. W-11, as amended, now fixes the date of presentation of the petition as the effective date of the winding-up.

TAB 2

2009 CarswellOnt 4465
Ontario Superior Court of Justice [Commercial List]

Indalex Ltd., Re

2009 CarswellOnt 4465, [2009] O.J. No. 3165, 179 A.C.W.S. (3d) 267, 55 C.B.R. (5th) 64, 79 C.C.P.B. 104

IN THE MATTER OF THE COMPANIES' CREDITORS ARRANGEMENT ACT, R.S.C., c. C-36, AS AMENDED

AND IN THE MATTER OF A PLAN OF COMPROMISE OR ARRANGEMENT OF INDALEX LIMITED, INDALEX HOLDINGS (B.C.) LTD., 6326765 CANADIAN INC. AND NOVAR INC. (Applicants)

Morawetz J.

Heard: July 2, 2009
Judgment: July 2, 2009
Written reasons: July 24, 2009
Docket: CV-09-8122-00CL

Counsel: Linc Rogers, Katherine McEachern, Jackie Moher for Applicants
Ashley Taylor, Lesley Mercer for Monitor, FTI Consulting Canada ULC
Paul Macdonald, Jeff Levine for JPMorgan (DIP Lender)
Kenneth D. Kraft for SAPA Holding AB
Andrew Hatnay, Demetrios Yiokaris, Andrew Mckinnon for Keith Carruthers and SERP Retirees
B. Empey for Sun Indalex Finance LLC
John D. Leslie for U.S. Unsecured Creditors' Committee
G. Finlayson for U.S. Bank as Trustee for the Noteholders

Subject: Insolvency

Headnote

Bankruptcy and insolvency --- Proposal — Companies' Creditors Arrangement Act — Miscellaneous issues

Pension plan — Members of supplemental executive retirement plan ("SERP") had contractual entitlement to pension benefits under supplement retirement plan ("supplemental plan") for executive employees of I and associated companies — Supplemental plan was unfunded and non-registered supplemental pension plan — Supplemental pension benefits were stopped after I applicants filed for protection under Companies' Creditors Arrangement Act ("CCAA") — SERP group brought motion for order requiring I applicants to reinstate payment of supplemental pension benefits — Motion was opposed by I applicants, noteholders and DIP lender — Motion dismissed — SERP payments were based on services provided to I prior to CCAA filing and obligations were pre-filing obligations — Breach of SERP payment obligations gave rise to unsecured claim of SERP group against I applicants but SERP group was stayed from enforcing those payment obligations — SERP group did not establish that they were entitled to any priority with respect to benefits and there was no basis in principle to treat SERP group differently than any other unsecured creditor — Reinstatement of SERP payments would represent improper re-ordering of existing priority regime — SERP payments were not required to carry on business and therefore I was not authorized to pay monthly SERP payments.

Table of Authorities

Cases considered by *Morawetz J.*:

Doman Industries Ltd., Re (2004), 45 B.L.R. (3d) 78, 29 B.C.L.R. (4th) 178, 2004 CarswellBC 1262, 2004 BCSC 733, 1 C.B.R. (5th) 7 (B.C. S.C.) — distinguished

Nortel Networks Corp., Re (2009), 2009 CarswellOnt 3583 (Ont. S.C.J. [Commercial List]) — referred to

Statutes considered:

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

Forest Act, R.S.B.C. 1996, c. 157
Generally — referred to

MOTION by members of retirement plan for order to reinstate payment of supplemental pension benefits.

***Morawetz J.*:**

1 I heard argument in this matter on July 2, 2009 at the conclusion of which I dismissed the motion with reasons to follow. These are those reasons.

2 Members of the Indalex Supplemental Executive Retirement Plan or "SERP", (referred to collectively as the "SERP Group") brought this motion for an order requiring the Indalex Applicants to reinstate payment of supplemental pension benefits retroactive to April 2009.

3 The motion is opposed by the Indalex Applicants, the Noteholders and by the DIP Lender. Counsel to the DIP Lender submits that if these payments are made, they would constitute an event of default under the DIP Agreement. Such payments would need the consent or waiver from the DIP Lender which counsel submits, is not forthcoming.

4 The SERP Group have a contractual entitlement to pension benefits under the Supplemental Retirement Plan for executive employees of Indalex Limited and associated companies (the "Supplemental Plan").

5 The Supplemental Plan is an unfunded and non-registered supplemental pension plan. Benefits under the Supplemental Plan are paid out of the general revenues of the Indalex Applicants.

6 Immediately after filing for CCAA protection on April 3, 2009, the Indalex Applicants informed the SERP Group that their supplemental pension benefits were being stopped.

7 The situation confronting members of the SERP Group is very similar to that faced by certain former employees of Nortel Networks ("Former Nortel Employees") who recently brought a motion requesting an order requiring the Applicants in Nortel's CCAA proceedings (the "Nortel Applicants") to make payments which the Nortel Applicants were contractually obligated to pay to Former Nortel Employees, relating to the Transitional Retirement Allowance and any pension benefit payments Former Nortel Employees were entitled to receive in excess of the pension plan. The motion was dismissed. (See *Nortel Networks Corp., Re*, 2009 CarswellOnt 3583 (Ont. S.C.J. [Commercial List]).

8 The reasons provided for the dismissal of the motion of the Former Nortel Employees are applicable to this case.

9 SERP payments are based on services provided to Indalex prior to April 2009. These obligations are, in my view, pre-filing unsecured obligations. A breach of the SERP payment obligations gives rise to an unsecured claim of the SERP Group against the Indalex Applicants. The SERP Group is stayed from enforcing these payment obligations.

10 The SERP Group has not established that they are entitled to any priority with respect to their SERP benefits and there is, in my view, no basis in principle, to treat the SERP Group differently than any other unsecured creditors of the Indalex Applicants. The reinstatement of the SERP payments would, in my view, represent an improper re-ordering of the existing priority regime.

11 The Amended and Restated Order authorizes the Indalex Applicants to pay all reasonable expenses incurred by the Indalex Applicants in carrying on their business in the ordinary course. SERP payments are not, in my view, payments required to carry on the business and, accordingly, the Indalex Applicants are not authorized to pay the monthly SERP payments.

12 In certain CCAA proceedings, the court has granted relief to permit payment of pre-filing unsecured debt. However, in these cases, such payments have for the most part, been considered to be crucial to the ongoing business of the debtor company. In this case, the Indalex Applicants are seeking a going concern solution for the benefit of all stakeholders and their resources should be used for such purposes. I have not been persuaded that the SERP payments are crucial to the ongoing business of the Indalex Applicants and such payments offer no apparent benefit to the Indalex Applicants. (*Re Nortel*, *supra*, at paragraphs 80 and 86.)

13 The SERP Group submits that there are hardship issues that should be taken into account. In Nortel, a hardship exception was made. However, the Nortel exception was predicated, in part, on the reasonable expectation that there will be a meaningful distribution to unsecured creditors, including the Former Nortel Employees. The Nortel hardship exception recognizes that any distribution would represent an advance on the general distribution. The situation facing the Indalex Applicants is different. The Indalex Applicants have significant secured creditors and unlike the situation in Nortel, it is premature to comment on the prospects of any meaningful distribution to unsecured creditors.

14 Counsel to SERP Group also submitted that CCAA protection in this case had been obtained for a company that was liquidating its assets. Counsel for the SERP Group submitted that Indalex had put itself up for sale and commenced a "marketing process" and as such it was not restructuring, rather, it was selling itself. This led to the submission that the cutting of benefits payable to the SERP Group was not necessary or justified for the sale of the company under the CCAA.

15 I fail to see the relevance of this submission. At the present time, the Applicants are properly under CCAA protection. No motion has been brought to challenge the appropriateness of the CCAA proceedings and, in my view, nothing in the CCAA precludes the ability of a debtor applicant to sell its assets. See *Re Nortel Networks Corporation* - endorsement released July 23, 2009 on this point.

16 Finally, counsel to SERP Group placed emphasis on the fact that the amount required to satisfy the obligations to SERP Group is not significant. While this submission may be attractive on the surface, to give effect to this argument would violate a fundamental tenet of insolvency law, namely, that all unsecured creditors receive equal treatment. In my view, there is no basis to prefer the SERP Group or, indeed, any retired executive who is entitled to SERP payments in priority to other unsecured creditors.

17 Counsel to SERP Group also relied upon *Doman Industries Ltd., Re*, 2004 BCSC 733 (B.C. S.C.) for the proposition that, the fact that a company can reduce its costs if it can terminate contracts, is not sufficient for a CCAA court to authorize the termination of the contract. In *Doman*, *supra*, the point at issue concerned licences under the *Forest Act* which created the concept of replaceable contracts. Doman held certain licences. As noted by Tysoe J. (as he then was), at paragraph 7, a replaceable contract is a form of evergreen contract which contains statutorily mandated provisions, the most important of which is that the licence holder must offer a new or replacement contract to the contractor upon each expiry of the term of the contract as long as the contractor is not in default under the contract. That is not the situation in this case. The contractual situation in *Doman*, *supra*, is not, in my view, comparable to this case. *Doman*is clearly distinguishable on the facts.

18 For the forgoing reasons, the motion of SERP Group for reinstatement of SERP benefits is dismissed.

Motion dismissed.

End of Document

TAB 3

2012 SCC 67
Supreme Court of Canada

AbitibiBowater Inc., Re

2012 CarswellQue 12490, 2012 CarswellQue 12491, 2012 SCC 67, [2012] 3 S.C.R. 443, [2012] A.C.S. No. 67, [2012] S.C.J. No. 67, 221 A.C.W.S. (3d) 264, 352 D.L.R. (4th) 399, 438 N.R. 134, 71 C.E.L.R. (3d) 1, 95 C.B.R. (5th) 200, J.E. 2012-2270

Her Majesty the Queen in Right of the Province of Newfoundland and Labrador, Appellant and AbitibiBowater Inc., Abitibi-Consolidated Inc., Bowater Canadian Holdings Inc., Ad Hoc Committee of Bondholders, Ad Hoc Committee of Senior Secured Noteholders and U.S. Bank National Association (Indenture Trustee for the Senior Secured Noteholders), Respondents and Attorney General of Canada, Attorney General of Ontario, Attorney General of British Columbia, Attorney General of Alberta, Her Majesty the Queen in Right of British Columbia, Ernst & Young Inc., as Monitor, and Friends of the Earth Canada, Interveners

McLachlin C.J.C., LeBel, Deschamps, Fish, Abella, Rothstein, Cromwell, Moldaver, Karakatsanis JJ.

Heard: November 16, 2011
Judgment: December 7, 2012
Docket: 33797

Proceedings: affirmed *AbitibiBowater Inc., Re* (2010), 68 C.B.R. (5th) 57, 52 C.E.L.R. (3d) 1, 2010 CarswellQue 4782, 2010 QCCA 965, Chamberland J.A. (C.A. Que.); refused leave to appealdemande d'autorisation d'en appeler refusée *AbitibiBowater Inc., Re* (2010), 68 C.B.R. (5th) 1, 52 C.E.L.R. (3d) 17, 2010 QCCS 1261, 2010 CarswellQue 2812, Clément Gascon J.C.S (C.S. Que.)

Counsel: David R. Wingfield, Paul D. Guy, Philip Osborne, for Appellant
Sean F. Dunphy, Nicholas McHaffie, Joseph Reynaud, Marc B. Barbeau, for Respondents
Christopher Rupar, Marianne Zoric, for Intervener, Attorney General of Canada
Josh Hunter, Robin K. Basu, Leonard Marsello, Mario Faieta, for Intervener, Attorney General of Ontario
R. Richard M. Butler, for Intervener, Attorney General of British Columbia
Roderick Wiltshire, for Intervener, Attorney General of Alberta
Elizabeth J. Rowbotham, for Intervener, Her Majesty The Queen in Right of British Columbia
Robert I. Thornton, John T. Porter, Rachelle F. Moncur, for Intervener, Ernst & Young Inc., as Monitor
William A. Amos, Anastasia M. Lintner, Hugh S. Wilkins, R. Graham Phoenix, for Intervener, Friends of the Earth Canada

Subject: Insolvency; Environmental

Headnote

Bankruptcy and insolvency --- Proving claim — Provable debts — Contingent claims

A Inc. experienced financial difficulties and announced closure of mill in province — One year later, A Inc. sought protection under Companies' Creditors Arrangement Act (CCAA), and claims procedure order was issued — Province's Minister of Environment and Conservation issued five orders requiring A Inc. to perform remedial work — Province then brought motion for declaration that claims procedure order did not bar province from enforcing its orders — Trial judge found that province's orders were monetary in nature and, as such, were subject to claims procedure order — Province brought motion for leave to appeal — Court of Appeal held that trial judge had found

as fact that orders were monetary in nature and denied leave to appeal — Province appealed to Supreme Court of Canada — Appeal dismissed — There are three requirements orders must meet in order to be considered claims that may be subject to insolvency process: first, there must be creditor; second, debt, liability or obligation must be incurred before debtor becomes bankrupt; and third, it must be possible to attach monetary value to debt, liability or obligation — Here, province identified itself as creditor by resorting to environmental protection enforcement mechanisms — Further, environmental damage had occurred before time of CCAA proceedings — While province had not yet formally exercised its power to ask for payment of money, it was sufficiently certain that province's orders would eventually result in monetary claim — Therefore, trial judge's finding that province was creditor with monetary claim that should be subject to CCAA process was confirmed.

Bankruptcy and insolvency --- Companies' Creditors Arrangement Act — Initial application — Proceedings subject to stay — Crown claims

A Inc. experienced financial difficulties and announced closure of mill in province — One year later, A Inc. sought protection under Companies' Creditors Arrangement Act (CCAA), and claims procedure order was issued — Province's Minister of Environment and Conservation issued five orders requiring A Inc. to perform remedial work — Province then brought motion for declaration that claims procedure order did not bar province from enforcing its orders — Trial judge found that province's orders were monetary in nature and, as such, were subject to claims procedure order — Province brought motion for leave to appeal — Court of Appeal held that trial judge had found as fact that orders were monetary in nature and denied leave to appeal — Province appealed to Supreme Court of Canada — Appeal dismissed — There are three requirements orders must meet in order to be considered claims that may be subject to insolvency process: first, there must be creditor; second, debt, liability or obligation must be incurred before debtor becomes bankrupt; and third, it must be possible to attach monetary value to debt, liability or obligation — Here, province identified itself as creditor by resorting to environmental protection enforcement mechanisms — Further, environmental damage had occurred before time of CCAA proceedings — While province had not yet formally exercised its power to ask for payment of money, it was sufficiently certain that province's orders would eventually result in monetary claim — Therefore, trial judge's finding that province was creditor with monetary claim that should be subject to CCAA process was confirmed.

Environmental law --- Liability for environmental harm — Nuisance — Liability in particular cases — Miscellaneous

A Inc. experienced financial difficulties and announced closure of mill in province — One year later, A Inc. sought protection under Companies' Creditors Arrangement Act (CCAA), and claims procedure order was issued — Province's Minister of Environment and Conservation issued five orders requiring A Inc. to perform remedial work — Province then brought motion for declaration that claims procedure order did not bar province from enforcing its orders — Trial judge found that province's orders were monetary in nature and, as such, were subject to claims procedure order — Province brought motion for leave to appeal — Court of Appeal held that trial judge had found as fact that orders were monetary in nature and denied leave to appeal — Province appealed to Supreme Court of Canada — Appeal dismissed — There are three requirements orders must meet in order to be considered claims that may be subject to insolvency process: first, there must be creditor; second, debt, liability or obligation must be incurred before debtor becomes bankrupt; and third, it must be possible to attach monetary value to debt, liability or obligation — Here, province identified itself as creditor by resorting to environmental protection enforcement mechanisms — Further, environmental damage had occurred before time of CCAA proceedings — While province had not yet formally exercised its power to ask for payment of money, it was sufficiently certain that province's orders would eventually result in monetary claim — Therefore, trial judge's finding that province was creditor with monetary claim that should be subject to CCAA process was confirmed.

Faillite et insolvabilité --- Preuve de réclamation — Créances prouvables — Réclamations éventuelles

A Inc. éprouvait des difficultés financières et a annoncé la fermeture d'une scierie dans la province — Un an plus tard, A Inc. s'est placée sous la protection de la Loi sur les arrangements avec les créanciers des compagnies (LACC), et une ordonnance relative à la procédure de réclamations a été émise — Ministre provincial de l'Environnement et

de la Conservation a prononcé cinq ordonnances contraignant A Inc. à exécuter des travaux de décontamination — Province a ensuite déposé une requête visant à obtenir une déclaration que l'ordonnance relative à la procédure de réclamations n'empêchait pas la province d'exécuter ses ordonnances — Juge de première instance a conclu que les ordonnances émises par la province demeuraient de nature véritablement financière et pécuniaire et, ainsi, étaient assujetties à l'ordonnance relative à la procédure de réclamations — Province a déposé une requête en permission d'appeler — Cour d'appel a estimé que le juge de première instance avait conclu, comme question de fait, que les ordonnances étaient de nature pécuniaire et a refusé d'autoriser l'appel — Province a formé un pourvoi devant la Cour suprême du Canada — Pourvoi rejeté — Pour qu'elles constituent des réclamations pouvant être assujetties au processus applicable en matière d'insolvabilité, les ordonnances doivent satisfaire à trois conditions : premièrement, il doit y avoir un créancier; deuxièmement, la dette, l'engagement ou l'obligation doit avoir pris naissance avant que le débiteur ne fasse faillite; et troisièmement, il doit être possible d'attribuer une valeur pécuniaire à cette dette, cet engagement ou cette obligation — En l'espèce, la province s'est présentée comme créancière en ayant recours aux mécanismes d'application en matière de protection de l'environnement — De plus, les dommages environnementaux étaient survenus avant que les procédures en vertu de la LACC ne soient entamées — Enfin, bien que la province n'avait pas encore formellement exercé son pouvoir de demander paiement d'une somme d'argent, il était suffisamment certain que les ordonnances émises par la province mèneraient éventuellement à la présentation d'une réclamation pécuniaire — Par conséquent, la conclusion du juge de première instance selon laquelle la province était une créancière ayant une réclamation pécuniaire qui devrait être assujettie au processus régi par la LACC a été confirmée.

Faillite et insolvabilité --- Loi sur les arrangements avec les créanciers des compagnies — Demande initiale — Procédures assujetties à la suspension — Créances de l'État

A Inc. éprouvait des difficultés financières et a annoncé la fermeture d'une scierie dans la province — Un an plus tard, A Inc. s'est placée sous la protection de la Loi sur les arrangements avec les créanciers des compagnies (LACC), et une ordonnance relative à la procédure de réclamations a été émise — Ministre provincial de l'Environnement et de la Conservation a prononcé cinq ordonnances contraignant A Inc. à exécuter des travaux de décontamination — Province a ensuite déposé une requête visant à obtenir une déclaration que l'ordonnance relative à la procédure de réclamations n'empêchait pas la province d'exécuter ses ordonnances — Juge de première instance a conclu que les ordonnances émises par la province demeuraient de nature véritablement financière et pécuniaire et, ainsi, étaient assujetties à l'ordonnance relative à la procédure de réclamations — Province a déposé une requête en permission d'appeler — Cour d'appel a estimé que le juge de première instance avait conclu, comme question de fait, que les ordonnances étaient de nature pécuniaire et a refusé d'autoriser l'appel — Province a formé un pourvoi devant la Cour suprême du Canada — Pourvoi rejeté — Pour qu'elles constituent des réclamations pouvant être assujetties au processus applicable en matière d'insolvabilité, les ordonnances doivent satisfaire à trois conditions : premièrement, il doit y avoir un créancier; deuxièmement, la dette, l'engagement ou l'obligation doit avoir pris naissance avant que le débiteur ne fasse faillite; et troisièmement, il doit être possible d'attribuer une valeur pécuniaire à cette dette, cet engagement ou cette obligation — En l'espèce, la province s'est présentée comme créancière en ayant recours aux mécanismes d'application en matière de protection de l'environnement — De plus, les dommages environnementaux étaient survenus avant que les procédures en vertu de la LACC ne soient entamées — Enfin, bien que la province n'avait pas encore formellement exercé son pouvoir de demander paiement d'une somme d'argent, il était suffisamment certain que les ordonnances émises par la province mèneraient éventuellement à la présentation d'une réclamation pécuniaire — Par conséquent, la conclusion du juge de première instance selon laquelle la province était une créancière ayant une réclamation pécuniaire qui devrait être assujettie au processus régi par la LACC a été confirmée.

Droit de l'environnement --- Responsabilité pour dommages causés à l'environnement — Nuisance — Catégories particulières de responsabilité — Divers

A Inc. éprouvait des difficultés financières et a annoncé la fermeture d'une scierie dans la province — Un an plus tard, A Inc. s'est placée sous la protection de la Loi sur les arrangements avec les créanciers des compagnies (LACC),

et une ordonnance relative à la procédure de réclamations a été émise — Ministre provincial de l'Environnement et de la Conservation a prononcé cinq ordonnances contraignant A Inc. à exécuter des travaux de décontamination — Province a ensuite déposé une requête visant à obtenir une déclaration que l'ordonnance relative à la procédure de réclamations n'empêchait pas la province d'exécuter ses ordonnances — Juge de première instance a conclu que les ordonnances émises par la province demeuraient de nature véritablement financière et pécuniaire et, ainsi, étaient assujetties à l'ordonnance relative à la procédure de réclamations — Province a déposé une requête en permission d'appeler — Cour d'appel a estimé que le juge de première instance avait conclu, comme question de fait, que les ordonnances étaient de nature pécuniaire et a refusé d'autoriser l'appel — Province a formé un pourvoi devant la Cour suprême du Canada — Pourvoi rejeté — Pour qu'elles constituent des réclamations pouvant être assujetties au processus applicable en matière d'insolvabilité, les ordonnances doivent satisfaire à trois conditions : premièrement, il doit y avoir un créancier; deuxièmement, la dette, l'engagement ou l'obligation doit avoir pris naissance avant que le débiteur ne fasse faillite; et troisièmement, il doit être possible d'attribuer une valeur pécuniaire à cette dette, cet engagement ou cette obligation — En l'espèce, la province s'est présentée comme créancière en ayant recours aux mécanismes d'application en matière de protection de l'environnement — De plus, les dommages environnementaux étaient survenus avant que les procédures en vertu de la LACC ne soient entamées — Enfin, bien que la province n'avait pas encore formellement exercé son pouvoir de demander paiement d'une somme d'argent, il était suffisamment certain que les ordonnances émises par la province mèneraient éventuellement à la présentation d'une réclamation pécuniaire — Par conséquent, la conclusion du juge de première instance selon laquelle la province était une créancière ayant une réclamation pécuniaire qui devrait être assujettie au processus régi par la LACC a été confirmée.

In 2008, A Inc. experienced financial difficulties and announced the closure of a mill in the province. One year later, A Inc. sought protection under the Companies' Creditors Arrangement Act (CCAA), and a claims procedure order was issued. Province's Minister of Environment and Conservation issued five orders under s. 99 of the Environmental Protection Act (the "EPA orders") requiring A Inc. to submit remediation action plans to the Minister and to complete them. The province then brought a motion for a declaration that the claims procedure order did not bar the province from enforcing the EPA orders.

The trial judge dismissed the province's motion. The trial judge found that the EPA orders remained truly financial and monetary in nature and, as such, were subject to the claims procedure order. The province brought a motion for leave to appeal.

The Court of Appeal held that the appeal had no reasonable chance of success because the trial judge had found as a fact that the orders were financial or monetary in nature, and it denied leave to appeal. The province appealed to the Supreme Court of Canada.

Held: The appeal was dismissed.

Per Deschamps J. (Fish, Abella, Rothstein, Cromwell, Moldaver, Karakatsanis JJ. concurring): The CCAA provides a single proceeding model, which ensures that most claims against a debtor are entertained in a single forum. In light of wording of the CCAA, the legislative history and the purpose of the reorganization process, to exempt environmental orders would be inconsistent with the insolvency legislation. However, courts will not necessarily conclude that all orders will be subject to the CCAA process. Courts must determine whether the facts indicate that the conditions for inclusion in the claims process are met. There are three requirements orders must meet in order to be considered claims that may be subject to the insolvency process. First, there must be a creditor. Here, the province identified itself as a creditor by resorting to environmental protection enforcement mechanisms. Second, the debt, liability or obligation must be incurred before the debtor becomes bankrupt. Here, the environmental damage occurred before the time of the CCAA proceedings. Third, it must be possible to attach a monetary value to the debt, liability or obligation. Here, the province had not yet formally exercised its power to

ask for the payment of money. Thus, the question was whether it was sufficiently certain that the EPA orders would eventually result in a monetary claim. The trial judge relied on a unique and inescapable set of facts — including the fact that the province actually intended to perform the remediation work itself and assert a claim against A Inc. — to conclude that it was. The majority held that the trial judge reviewed all the legal principles and facts that needed to be considered in order to make the determination in the case at bar. Therefore, the majority confirmed the trial judge's finding that the province was a creditor with a monetary claim that should be subject to the CCAA process.

The majority noted that subjecting an order to the claims process merely ensures that the creditor's claim will be paid in accordance with insolvency legislation. It does not extinguish the debtor's obligation to pay its debts, it does not exempt the debtor from complying with environmental regulations and it does not invite corporations to restructure in order to rid themselves of their environmental liabilities.

Per McLachlin C.J.C. (dissenting): The CCAA draws a fundamental distinction between ongoing regulatory obligations owed to the public, which generally survive the restructuring, and monetary claims that can be compromised. Remediation orders made under a province's environmental protection legislation impose ongoing regulatory obligations on the corporation required to clean up the pollution. In narrow circumstances, where a province has done the work or where it is "sufficiently certain" that it will do the work, the regulatory obligation would be extinguished and the province would have a monetary claim for the cost of remediation in the CCAA proceedings. Here, the Minister had neither done the clean-up work nor was it sufficiently certain that he or she would do so. Therefore, the EPA orders were not monetary claims compromisable under the CCAA.

Per LeBel J. (dissenting): The only regulatory orders that can be subject to compromise are those which are monetary in nature. The trial judge's decision was not consistent with the principle that the CCAA does not apply to purely regulatory obligations. Based on the evidence before him, the trial judge could not conclude with "sufficient certainty" that the province would perform the remedial work itself. In fact, it appeared that the trial judge was more concerned with the fact that the arrangement would fail if A Inc. was not released from its regulatory obligations. Therefore, the EPA orders were not monetary claims compromisable under the CCAA.

En 2008, A Inc. éprouvait des difficultés financières et a annoncé la fermeture d'une scierie dans la province. Un an plus tard, A Inc. s'est placée sous la protection de la Loi sur les arrangements avec les créanciers des compagnies (LACC), et une ordonnance relative à la procédure de réclamations a été émise. Le ministre provincial de l'Environnement et de la Conservation a prononcé, en vertu de l'art. 99 de l'Environmental Protection Act, cinq ordonnances (les « ordonnances EPA ») contraignant A Inc. à présenter au ministre des plans de restauration et à les réaliser. La province a ensuite déposé une requête visant à obtenir une déclaration que l'ordonnance relative à la procédure de réclamations n'empêchait pas la province d'exécuter les ordonnances EPA.

Le juge de première instance a rejeté la requête de la province. Le juge de première instance a conclu que les ordonnances EPA demeuraient de nature véritablement financière et pécuniaire et, ainsi, étaient assujetties à l'ordonnance relative à la procédure de réclamations. La province a déposé une requête en permission d'appeler.

La Cour d'appel a estimé que l'appel n'avait aucune chance raisonnable de succès parce que le juge de première instance avait conclu, comme question de fait, que les ordonnances EPA étaient de nature financière ou pécuniaire, et elle a refusé d'autoriser l'appel. La province a formé un pourvoi devant la Cour suprême du Canada.

Arrêt: Le pourvoi a été rejeté.

Deschamps, J. (Fish, Abella, Rothstein, Cromwell, Moldaver, Karakatsanis, JJ., souscrivant à son opinion) : La LACC prévoit une procédure unique permettant de traiter la presque totalité des réclamations contre un débiteur devant un même tribunal. Considérant le libellé de la LACC, de l'historique des dispositions législatives

et des objectifs du processus de réorganisation, une exemption à l'égard des ordonnances environnementales serait incompatible avec la législation en matière d'insolvabilité. Toutefois, les tribunaux ne vont pas nécessairement conclure que toutes les ordonnances seront assujetties au processus régi par la LACC. Les tribunaux doivent déterminer si le contexte factuel indique que les conditions requises pour que l'ordonnance soit incluse dans le processus de réclamations sont respectées. Pour qu'elles constituent des réclamations pouvant être assujetties au processus applicable en matière d'insolvabilité, les ordonnances doivent satisfaire à trois conditions. Premièrement, il doit y avoir un créancier. En l'espèce, la province s'est présentée comme créancière en ayant recours aux mécanismes d'application en matière de protection de l'environnement. Deuxièmement, la dette, l'engagement ou l'obligation doit avoir pris naissance avant que le débiteur ne fasse faillite. En l'espèce, les dommages environnementaux sont survenus avant que les procédures en vertu de la LACC ne soient entamées. Troisièmement, il doit être possible d'attribuer une valeur pécuniaire à cette dette, cet engagement ou cette obligation. En l'espèce, la province n'avait pas encore formellement exercé son pouvoir de demander paiement d'une somme d'argent. Ainsi, la question était de savoir s'il était suffisamment certain que les ordonnances EPA mèneraient éventuellement à la présentation d'une réclamation pécuniaire. En se fondant sur un contexte factuel unique et dont il ne pouvait pas faire abstraction, y compris le fait que la province avait de fait l'intention d'exécuter les travaux de décontamination elle-même pour ensuite présenter une réclamation contre A Inc., le juge de première instance a conclu que c'était le cas. Les juges majoritaires ont estimé que le juge de première instance a examiné tous les principes juridiques et les faits qu'il était tenu de prendre en compte pour statuer sur la question qui se posait en l'espèce. Par conséquent, les juges majoritaires ont confirmé la conclusion du juge de première instance selon laquelle la province était une créancière ayant une réclamation pécuniaire qui devrait être assujettie au processus régi par la LACC.

Les juges majoritaires ont fait remarquer que le fait d'assujettir une ordonnance au processus de réclamation vise simplement à faire en sorte que le paiement au créancier sera fait conformément aux dispositions législatives applicables en matière d'insolvabilité. Cela n'éteint pas l'obligation du débiteur de payer ses dettes, ni le dégage de son obligation de respecter la réglementation environnementale, ni n'incite les sociétés à se réorganiser dans le but d'échapper à leurs obligations environnementales.

McLachlin, J.C.C. (dissidente) : La LACC établit une distinction fondamentale entre les exigences réglementaires continues établies en faveur du public, lesquelles continuent de s'appliquer après la restructuration, et les réclamations pécuniaires qui peuvent faire l'objet d'une transaction. Les ordonnances exigeant la décontamination émises aux termes d'une loi provinciale sur la protection de l'environnement imposent des exigences réglementaires continues à la personne morale requise de remédier à la pollution. En certaines circonstances particulières, lorsqu'une province a exécuté les travaux ou lorsqu'il est « suffisamment certain » qu'elle exécutera les travaux, l'exigence réglementaire serait éteinte et la province pourrait produire, dans le cadre de procédures engagées sous le régime de la LACC, une réclamation pécuniaire couvrant le coût des travaux de décontamination. En l'espèce, le ministre n'a pas effectué les travaux de décontamination et il n'était pas suffisamment certain qu'il le ferait. Par conséquent, les ordonnances EPA ne constituaient pas des réclamations pécuniaires pouvant faire l'objet d'une transaction aux termes de la LACC.

LeBel, J. (dissident) : Les seules ordonnances réglementaires pouvant faire l'objet d'une transaction sont celles qui sont de nature pécuniaire. La décision du juge de première instance n'était pas conforme avec le principe selon lequel la LACC ne s'applique pas aux exigences purement réglementaires. En se fondant sur la preuve dont il disposait, le juge de première instance ne pouvait pas conclure avec « suffisamment de certitude » que la province exécuterait les travaux de décontamination elle-même. En fait, il semblait que le juge de première instance était davantage préoccupé par le fait que l'arrangement risquait d'échouer si A Inc. n'était pas libérée de ses exigences réglementaires. Par conséquent, les ordonnances EPA ne constituaient pas des réclamations pécuniaires pouvant faire l'objet d'une transaction aux termes de la LACC.

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APPEAL by province from decision reported at *AbitibiBowater Inc., Re* (2010), 68 C.B.R. (5th) 57, 52 C.E.L.R. (3d) 1, 2010 CarswellQue 4782, 2010 QCCA 965 (C.A. Que.), denying leave to appeal decision dismissing its motion for declaration that claims procedure order issued under *Environmental Protection Act* (Nfld.) did not bar province from enforcing orders requiring debtor to perform remedial work.

POURVOI formé par la province à l'encontre d'une décision publiée à *AbitibiBowater Inc., Re* (2010), 68 C.B.R. (5th) 57, 52 C.E.L.R. (3d) 1, 2010 CarswellQue 4782, 2010 QCCA 965 (C.A. Que.), ayant refusé d'accorder la permission d'interjeter appel à l'encontre d'une décision ayant rejeté sa requête visant à faire déclarer que l'ordonnance relative à la procédure de réclamations émise en vertu de l'*Environmental Protection Act* n'empêchait pas la province d'exécuter les ordonnances enjoignant la débitrice d'exécuter des travaux de décontamination.

***Deschamps J.*:**

1 The question in this appeal is whether orders issued by a regulatory body with respect to environmental remediation work can be treated as monetary claims under the *Companies' Creditors Arrangement Act*, R.S.C. 1985, c. C-36 ("*CCAA*").

2 Regulatory bodies may become involved in reorganization proceedings when they order the debtor to comply with statutory rules. As a matter of principle, reorganization does not amount to a licence to disregard rules. Yet there are circumstances in which valid and enforceable orders will be subject to an arrangement under the *CCAA*. One such circumstance is where a regulatory body makes an environmental order that explicitly asserts a monetary claim.

3 In other circumstances, it is less clear whether an order can be treated as a monetary claim. The appellant and a number of interveners posit that an order issued by an environmental body is not a claim under the *CCAA* if the order does not require the debtor to make a payment. I agree that not all orders issued by regulatory bodies are monetary in nature and thus provable claims in an insolvency proceeding, but some may be, even if the amounts involved are not quantified at the outset of the proceeding. In the environmental context, the *CCAA* court must determine whether there are sufficient facts indicating the existence of an environmental duty that will ripen into a financial liability owed to the regulatory body that issued the order. In such a case, the relevant question is not simply whether the body has formally exercised its power to claim a debt. A *CCAA* court does not assess claims — or orders — on the basis of form alone. If the order is not framed in monetary terms, the court must determine, in light of the factual matrix and the applicable statutory framework, whether it is a claim that will be subject to the claims process.

4 The case at bar concerns contamination that occurred, prior to the *CCAA* proceedings, on property that is largely no longer under the debtor's possession and control. The *CCAA* court found on the facts of this case that the orders issued by Her Majesty the Queen in right of the Province of Newfoundland and Labrador ("Province") were simply a first step towards remediating the contaminated property and asserting a claim for the resulting costs. In the words of the *CCAA* court, "the intended, practical and realistic effect of the *EPA* Orders was to establish a basis for the Province to recover amounts of money to be eventually used for the remediation of the properties in question" (2010 QCCS 1261, 68 C.B.R. (5th) 1 (C.S. Que.), at para. 211). As a result, the *CCAA* court found that the orders were clearly monetary in nature. I see no error of law and no reason to interfere with this finding of fact. I would dismiss the appeal with costs.

I. Facts and Procedural History

5 For over 100 years, AbitibiBowater Inc. and its affiliated or predecessor companies (together, "Abitibi") were involved in industrial activity in Newfoundland and Labrador. In 2008, Abitibi announced the closure of a mill that was its last operation in that province.

6 Within two weeks of the announcement, the Province passed the *Abitibi-Consolidated Rights and Assets Act*, S.N.L. 2008, c. A-1.01 ("*Abitibi Act*"), which immediately transferred most of Abitibi's property in Newfoundland and Labrador to the Province and denied Abitibi any legal remedy for this expropriation.

7 The closure of its mill in Newfoundland and Labrador was one of many decisions Abitibi made in a period of general financial distress affecting its activities both in the United States and in Canada. It filed for insolvency protection in the United States on April 16, 2009. It also sought a stay of proceedings under the *CCAA* in the Superior Court of Quebec, as its Canadian head office was located in Montreal. The *CCAA* stay was ordered on April 17, 2009.

8 In the same month, Abitibi also filed a notice of intent to submit a claim to arbitration under NAFTA (the *North American Free Trade Agreement Between the Government of the United Mexican States and the Government of the United States of America*, Can. T.S. 1994 No. 2) for losses resulting from the *Abitibi Act*, which, according to Abitibi, exceeded $300 million.

9 On November 12, 2009, the Province's Minister of Environment and Conservation ("Minister") issued five orders ("*EPA* Orders") under s. 99 of the *Environmental Protection Act*, S.N.L. 2002, c. E-14.2 ("*EPA*"). The *EPA* Orders required Abitibi to submit remediation action plans to the Minister for five industrial sites, three of which had been expropriated, and to complete the approved remediation actions. The *CCAA* judge estimated the cost of implementing these plans to be from "the mid-to-high eight figures" to "several times higher" (para. 81).

10 On the day it issued the *EPA* Orders, the Province brought a motion for a declaration that a claims procedure order issued under the *CCAA* in relation to Abitibi's proposed reorganization did not bar the Province from enforcing the *EPA* Orders. The Province argued — and still argues — that non-monetary statutory obligations are not "claims" under the *CCAA* and hence cannot be stayed and be subject to a claims procedure order. It further submits that Parliament lacks

the constitutional competence under its power to make laws in relation to bankruptcy and insolvency to stay orders that are validly made in the exercise of a provincial power.

11 Abitibi contested the motion and sought a declaration that the *EPA* Orders were stayed and that they were subject to the claims procedure order. It argued that the *EPA* Orders were monetary in nature and hence fell within the definition of the word "claim" in the claims procedure order.

12 Gascon J. of the Quebec Superior Court, sitting as a *CCAA* court, dismissed the Province's motion. He found that he had the authority to characterize the orders as "claims" if the underlying regulatory obligations "remain[ed], in a particular fact pattern, truly financial and monetary in nature" (para. 148). He declared that the *EPA* Orders were stayed by the initial stay order and were not subject to the exception found in that order. He also declared that the filing by the Province of any claim based on the *EPA* Orders was subject to the claims procedure order, and reserved to the Province the right to request an extension of time to assert a claim under the claims procedure order and to Abitibi the right to contest such a request.

13 In the Court of Appeal, Chamberland J.A. denied the Province leave to appeal (2010 QCCA 965, 68 C.B.R. (5th) 57 (C.A. Que.)). In his view, the appeal had no reasonable chance of success, because Gascon J. had found as a fact that the *EPA* Orders were financial or monetary in nature. Chamberland J.A. also found that no constitutional issue arose, given that the Superior Court judge had merely characterized the orders in the context of the restructuring process; the judgment did not "'immunise' Abitibi from compliance with the EPA Orders" (para. 33). Finally, he noted that Gascon J. had reserved the Province's right to request an extension of time to file a claim in the *CCAA* process.

II. Positions of the Parties

14 The Province argues that the *CCAA* court erred in interpreting the relevant *CCAA* provisions in a way that nullified the *EPA*, and that the interpretation is inconsistent with both the ancillary powers doctrine and the doctrine of interjurisdictional immunity. The Province further submits that, in any event, the *EPA* Orders are not "claims" within the meaning of the *CCAA*. It takes the position that "any plan of compromise and arrangement that Abitibi might submit for court approval must make provision for compliance with the EPA Orders" (A.F., at para. 32).

15 Abitibi contends that the factual record does not provide a basis for applying the constitutional doctrines. It relies on the *CCAA* court's findings of fact, particularly the finding that the Province's intent was to establish the basis for a monetary claim. Abitibi submits that the true issue is whether a province that has a monetary claim against an insolvent company can obtain a preference against other unsecured creditors by exercising its regulatory power.

III. Constitutional Questions

16 At the Province's request, the Chief Justice stated the following constitutional questions:

> 1. Is the definition of "claim" in s. 2(1) of the *Companies' Creditors Arrangement Act*, R.S.C. 1985, c. C-36, *ultra vires* the Parliament of Canada or constitutionally inapplicable to the extent this definition includes statutory duties to which the debtor is subject pursuant to s. 99 of the *Environmental Protection Act*, S.N.L. 2002, c. E-14.2?
>
> 2. Is s. 11 of the *Companies' Creditors Arrangement Act*, R.S.C. 1985, c. C-36, *ultra vires* the Parliament of Canada or constitutionally inapplicable to the extent this section gives courts jurisdiction to bar or extinguish statutory duties to which the debtor is subject pursuant to s. 99 of the *Environmental Protection Act*, S.N.L. 2002, c. E-14.2?
>
> 3. Is s. 11 of the *Companies' Creditors Arrangement Act*, R.S.C. 1985, c. C-36, *ultra vires* the Parliament of Canada or constitutionally inapplicable to the extent this section gives courts jurisdiction to review the exercise of ministerial discretion under s. 99 of the *Environmental Protection Act*, S.N.L. 2002, c. E-14.2?

17 I note that the question whether a *CCAA* court has constitutional jurisdiction to stay a provincial order that is *not* a monetary claim does not arise here, because the stay order in this case did not affect non-monetary orders. However,

the question may arise in other cases. In 2007, Parliament expressly gave *CCAA* courts the power to stay regulatory orders that are not monetary claims by amending the *CCAA* to include the current version of s. 11.1(3) (*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, s. 65) ("2007 amendments"). Thus, future cases may give courts the opportunity to consider the question raised by the Province in an appropriate factual context. The only constitutional question that needs to be answered in this case concerns the jurisdiction of a *CCAA* court to determine whether an environmental order that is not framed in monetary terms is in fact a monetary claim.

18 Processing creditors' claims against an insolvent debtor in an equitable and orderly manner is at the heart of insolvency legislation, which falls under a head of power attributed to Parliament. Rules concerning the assessment of creditors' claims, such as the determination of whether a creditor has a monetary claim, relate directly to the equitable and orderly treatment of creditors in an insolvency process. There is no need to perform a detailed analysis of the pith and substance of the provisions on the assessment of claims in insolvency matters to conclude that the federal legislation governing the characterization of an order as a monetary claim is valid. Because the provisions relate directly to Parliament's jurisdiction, the ancillary powers doctrine is not relevant to this case. I also find that the interjurisdictional immunity doctrine is not applicable. A finding that a claim of an environmental creditor is monetary in nature does not interfere in any way with the creditor's activities. Its claim is simply subjected to the insolvency process.

19 What the Province is actually arguing is that courts should consider the form of an order rather than its substance. I see no reason why the Province's choice of order should not be scrutinized to determine whether the form chosen is consistent with the order's true purpose as revealed by the Province's own actions. If the Province's actions indicate that, in substance, it is asserting a provable claim within the meaning of federal legislation, then that claim can be subjected to the insolvency process. Environmental claims do not have a higher priority than is provided for in the *CCAA*. Considering substance over form prevents a regulatory body from artificially creating a priority higher than the one conferred on the claim by federal legislation. This Court recognized long ago that a province cannot disturb the priority scheme established by the federal insolvency legislation: *Husky Oil Operations Ltd. v. Minister of National Revenue*, [1995] 3 S.C.R. 453 (S.C.C.). Environmental claims are given a specific, and limited, priority under the *CCAA*. To exempt orders which are in fact monetary claims from the *CCAA* proceedings would amount to conferring upon provinces a priority higher than the one provided for in the *CCAA*.

IV. Claims under the CCAA

20 Several provisions of the *CCAA* have been amended since Abitibi filed for insolvency protection. Except where otherwise indicated, the provisions I refer to are those that were in force when the stay was ordered.

21 One of the central features of the *CCAA* scheme is the single proceeding model, which ensures that most claims against a debtor are entertained in a single forum. Under this model, the court can stay the enforcement of most claims against the debtor's assets in order to maintain the *status quo* during negotiations with the creditors. When such negotiations are successful, the creditors typically accept less than the full amounts of their claims. Claims have not necessarily accrued or been liquidated at the outset of the insolvency proceeding, and they sometimes have to be assessed in order to determine the monetary value that will be subject to compromise.

22 Section 12 of the *CCAA* establishes the basic rules for ascertaining whether an order is a claim that may be subjected to the insolvency process:

> [Definition of "claim"]
>
> **12.** (1) For the purposes of this 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*.
>
> [Determination of amount of claim]

(2) For the purposes of this Act, the amount represented by a claim of any secured or unsecured creditor shall be determined as follows:

(*a*) the amount of an unsecured claim shall be the amount

. . .

(iii) in the case of any other company, proof of which might be made under the *Bankruptcy and Insolvency Act*, but if the amount so provable is not admitted by the company, the amount shall be determined by the court on summary application by the company or by the creditor; and ...

23 Section 12 of the *CCAA* refers to the rules of the *Bankruptcy and Insolvency Act*, R.S.C. 1985, c. B-3 ("*BIA*"). Section 2 of the *BIA* defines a claim provable in bankruptcy:

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

24 This definition is completed by s. 121 of the *BIA*:

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.

25 *Sections* 121(2) and 135(1.1) of the *BIA* offer additional guidance for the determination of whether an order is a provable claim:

121. . . .

(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.

135. . . .

(1.1) The trustee shall determine whether any contingent claim or unliquidated claim is a provable claim, and, if a provable claim, the trustee shall value it, and the claim is thereafter, subject to this section, deemed a proved claim to the amount of its valuation.

26 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. I will examine each of these requirements in turn.

27 The *BIA*'s definition of a provable claim, which is incorporated by reference into the *CCAA*, requires the identification of a creditor. Environmental statutes generally provide for the creation of regulatory bodies that are empowered to enforce the obligations the statutes impose. Most environmental regulatory bodies can be creditors in respect of monetary or non-monetary obligations imposed by the relevant statutes. At this first stage of determining whether the regulatory body is a creditor, the question whether the obligation can be translated into monetary terms is not yet relevant. This issue will be broached later. The only determination that has to be made at this point is whether the regulatory body has exercised its enforcement power against a debtor. When it does so, it identifies itself as a creditor, and the requirement of this stage of the analysis is satisfied.

28 The enquiry into the second requirement is based on s. 121(1) of the *BIA*, which imposes a time limit on claims. A claim must be founded on an obligation that was "incurred before the day on which the bankrupt becomes bankrupt". Because the date when environmental damage occurs is often difficult to ascertain, s. 11.8(9) of the *CCAA* provides more temporal flexibility for environmental claims:

> **11.8.** . . .
>
> (9) A claim against a debtor company for costs of remedying any environmental condition or environmental damage affecting real property of the company shall be a claim under this Act, whether the condition arose or the damage occurred before or after the date on which proceedings under this Act were commenced.

29 The creditor's claim will be exempt from the single proceeding requirement if the debtor's corresponding obligation has not arisen as of the time limit for inclusion in the insolvency process. This could apply, for example, to a debtor's statutory obligations relating to polluting activities that continue after the reorganization, because in such cases, the damage continues to be sustained after the reorganization has been completed.

30 With respect to the third requirement, that it be possible to attach a monetary value to the obligation, the question is whether orders that are not expressed in monetary terms can be translated into such terms. I note that when a regulatory body claims an amount that is owed at the relevant date, that is, when it frames its order in monetary terms, the court does not need to make this determination, because what is being claimed is an "indebtedness" and therefore clearly falls within the meaning of "claim" as defined in s. 12(1) of the *CCAA*.

31 However, orders, which are used to address various types of environmental challenges, may come in many forms, including stop, control, preventative, and clean-up orders (D. Saxe, "Trustees' and Receivers' Environmental Liability Update", 49 C.B.R. (3d) 138, at p. 141). When considering an order that is not framed in monetary terms, courts must look at its substance and apply the rules for the assessment of claims.

32 Parliament recognized that regulatory bodies sometimes have to perform remediation work (see House of Commons, *Standing Committee on Industry*, No. 16, 2nd Sess., 35th Parl., June 11, 1996). When one does so, its claim with respect to remediation costs is subject to the insolvency process, but the claim is secured by a charge on the contaminated real property and certain other related property and benefits from a priority (s. 11.8(8) *CCAA*). Thus, Parliament struck a balance between the public's interest in enforcing environmental regulations and the interest of third-party creditors in being treated equitably.

33 If Parliament had intended that the debtor always satisfy all remediation costs, it would have granted the Crown a priority with respect to the totality of the debtor's assets. In light of the legislative history and the purpose of the reorganization process, the fact that the Crown's priority under s. 11.8(8) *CCAA* is limited to the contaminated property and certain related property leads me to conclude that to exempt environmental orders would be inconsistent with the insolvency legislation. As deferential as courts may be to regulatory bodies' actions, they must apply the general rules.

34 Unlike in proceedings governed by the common law or the civil law, a claim may be asserted in insolvency proceedings even if it is contingent on an event that has not yet occurred (for the common law, see *McLarty v. R.*, 2008 SCC 26, [2008] 2 S.C.R. 79 (S.C.C.), at paras. 17-18; for the civil law, see arts. 1497, 1508 and 1513 of the *Civil Code of Québec*, S.Q. 1991, c. 64). Thus, the broad definition of "claim" in the *BIA* includes *contingent* and *future* claims that would be unenforceable at common law or in the civil law. As for unliquidated claims, a *CCAA* court has the same power to assess their amounts as would a court hearing a case in a common law or civil law context.

35 The reason the *BIA* and the *CCAA* include a broad range of claims is to ensure fairness between creditors and finality in the insolvency proceeding for the debtor. In a corporate liquidation process, it is more equitable to allow as many creditors as possible to participate in the process and share in the liquidation proceeds. This makes it possible to include creditors whose claims have not yet matured when the corporate debtor files for bankruptcy, and thus avert a

situation in which they would be faced with an inactive debtor that cannot satisfy a judgment. The rationale is slightly different in the context of a corporate proposal or reorganization. In such cases, the broad approach serves not only to ensure fairness between creditors, but also to allow the debtor to make as fresh a start as possible after a proposal or an arrangement is approved.

36 The criterion used by courts to determine whether a contingent claim will be included in the insolvency process is whether the event that has not yet occurred is too remote or speculative: *Confederation Treasury Services Ltd., Re* (1997), 96 O.A.C. 75 (Ont. C.A.). In the context of an environmental order, this means that there must be sufficient indications that the regulatory body that triggered the enforcement mechanism will ultimately perform remediation work and assert a monetary claim to have its costs reimbursed. If there is sufficient certainty in this regard, the court will conclude that the order can be subjected to the insolvency process.

37 The exercise by the *CCAA* court of its jurisdiction to determine whether an order is a provable claim entails a certain scrutiny of the regulatory body's actions. This scrutiny is in some ways similar to judicial review. There is a distinction, however, and it lies in the object of the assessment that the *CCAA* court must make. The *CCAA* court does not review the regulatory body's exercise of discretion. Rather, it inquires into whether the facts indicate that the conditions for inclusion in the claims process are met. For example, if activities at issue are ongoing, the *CCAA* court may well conclude that the order cannot be included in the insolvency process because the activities and resulting damages will continue after the reorganization is completed and hence exceed the time limit for a claim. If, on the other hand, the regulatory body, having no realistic alternative but to perform the remediation work itself, simply delays framing the order as a claim in order to improve its position in relation to other creditors, the *CCAA* court may conclude that this course of action is inconsistent with the insolvency scheme and decide that the order has to be subject to the claims process. Similarly, if the property is not under the debtor's control and the debtor does not, and realistically will not, have the means to perform the remediation work, the *CCAA* court may conclude that it is sufficiently certain that the regulatory body will have to perform the work.

38 Certain indicators can thus be identified from the text and the context of the provisions to guide the *CCAA* court in determining whether an order is a provable claim, including whether the activities are ongoing, whether the debtor is in control of the property, and whether the debtor has the means to comply with the order. The *CCAA* court may also consider the effect that requiring the debtor to comply with the order would have on the insolvency process. Since the appropriate analysis is grounded in the facts of each case, these indicators need not all apply, and others may also be relevant.

39 Having highlighted three requirements for finding a claim to be provable in a *CCAA* process that need to be considered in the case at bar, I must now discuss certain policy arguments raised by the Province and some of the interveners.

40 These parties argue that treating a regulatory order as a claim in an insolvency proceeding extinguishes the debtor's environmental obligations, thereby undermining the polluter-pay principle discussed by this Court in *Cie pétrolière Impériale c. Québec (Tribunal administratif)*, 2003 SCC 58, [2003] 2 S.C.R. 624 (S.C.C.) (para. 24). This objection demonstrates a misunderstanding of the nature of insolvency proceedings. Subjecting an order to the claims process does not extinguish the debtor's environmental obligations any more than subjecting any creditor's claim to that process extinguishes the debtor's obligation to pay its debts. It merely ensures that the creditor's claim will be paid in accordance with insolvency legislation. Moreover, full compliance with orders that are found to be monetary in nature would shift the costs of remediation to third-party creditors, including involuntary creditors, such as those whose claims lie in tort or in the law of extra-contractual liability. In the insolvency context, the Province's position would result not only in a super-priority, but in the acceptance of a "third party-pay" principle in place of the polluter-pay principle.

41 Nor does subjecting the orders to the insolvency process amount to issuing a licence to pollute, since insolvency proceedings do not concern the debtor's future conduct. A debtor that is reorganized must comply with all environmental regulations going forward in the same way as any other person. To quote the colourful analogy of two American scholars,

"Debtors in bankruptcy have — and should have — no greater license to pollute in violation of a statute than they have to sell cocaine in violation of a statute" (D. G. Baird and T. H. Jackson, "Comment: *Kovacs* and Toxic Wastes in Bankruptcy" (1984), 36 *Stan. L. Rev.* 1199, at p. 1200).

42 Furthermore, corporations may engage in activities that carry risks. No matter what risks are at issue, reorganization made necessary by insolvency is hardly ever a deliberate choice. When the risks materialize, the dire costs are borne by almost all stakeholders. To subject orders to the claims process is not to invite corporations to restructure in order to rid themselves of their environmental liabilities.

43 And the power to determine whether an order is a provable claim does not mean that the court will necessarily conclude that the order before it will be subject to the *CCAA* process. In fact, the *CCAA* court in the case at bar recognized that orders relating to the environment may or may not be considered provable claims. It stayed only those orders that were monetary in nature.

44 The Province also argues that courts have in the past held that environmental orders cannot be interpreted as claims when the regulatory body has not yet exercised its power to assert a claim framed in monetary terms. The Province relies in particular on *Panamericana de Bienes y Servicios S.A. v. Northern Badger Oil & Gas Ltd.* (1991), 81 Alta. L.R. (2d) 45 (Alta. C.A.), and its progeny. In *Panamericana*, the Alberta Court of Appeal held that a receiver was personally liable for work under a remediation order and that the order was not a claim in insolvency proceedings. The court found that the duty to undertake remediation work is owed to the public at large until the regulator exercises its power to assert a monetary claim.

45 The first answer to the Province's argument is that courts have never shied away from putting substance ahead of form. They can determine whether the order is in substance monetary.

46 The second answer is that the provisions relating to the assessment of claims, particularly those governing contingent claims, contemplate instances in which the quantum is not yet established when the claims are filed. Whether, in the regulatory context, an obligation always entails the existence of a correlative right has been discussed by a number of scholars. Various theories of rights have been put forward (see W. N. Hohfeld, *Fundamental Legal Conceptions as Applied in Judicial Reasoning* (new ed. 2001); D. N. MacCormick, "Rights in Legislation", in P. M. S. Hacker and J. Raz, eds., *Law, Morality, and Society: Essays in Honour of H. L. A. Hart* (1977), 189). However, because the Province issued the orders in this case, it would be recognized as a creditor in respect of a right no matter which of these theories was applied. As interesting as the discussion may be, therefore, I do not need to consider which theory should prevail. The real question is not to whom the obligation is owed, as this question is answered by the statute, which determines who can require that it be discharged. Rather, the question is whether it is sufficiently certain that the regulatory body will perform the remediation work and, as a result, have a monetary claim.

47 The third answer to the Province's argument is that insolvency legislation has evolved considerably over the two decades since *Panamericana*. At the time of *Panamericana*, none of the provisions relating to environmental liabilities were in force. Indeed, some of those provisions were enacted very soon after, and seemingly in response to, that case. In 1992, Parliament shielded trustees from the very liability imposed on the receiver in *Panamericana* (*An Act to amend the Bankruptcy Act and to amend the Income Tax Act in consequence thereof*, S.C. 1992, c. 27, s. 9, amending s. 14 of the *BIA*). The 1997 amendments provided additional protection to trustees and monitors (S.C. 1997, c. 12). The 2007 amendments made it clear that a *CCAA* court has the power to determine that a regulatory order may be a claim and also provided criteria for staying regulatory orders (s. 65, amending the *CCAA* to include the current version of s. 11.1). The purpose of these amendments was to balance the creditor's need for fairness against the debtor's need to make a fresh start.

48 Whether the regulatory body has a contingent claim is a determination that must be grounded in the facts of each case. Generally, a regulatory body has discretion under environmental legislation to decide how best to ensure that regulatory obligations are met. Although the court should take care to avoid interfering with that discretion, the action of a regulatory body is nevertheless subject to scrutiny in insolvency proceedings.

V. Application

49 I now turn to the application of the principles discussed above to the case at bar. This case does not turn on whether the Province is the creditor of an obligation or whether damage had occurred as of the relevant date. Those requirements are easily satisfied, since the Province had identified itself as a creditor by resorting to *EPA* enforcement mechanisms and since the damage had occurred before the time of the *CCAA* proceedings. Rather, the issue centres on the third requirement: that the orders meet the criterion for admission as a pecuniary claim. The claim was contingent to the extent that the Province had not yet formally exercised its power to ask for the payment of money. The question is whether it was sufficiently certain that the orders would eventually result in a monetary claim. To the *CCAA* judge, there was no doubt that the answer was yes.

50 The Province's exercise of its legislative powers in enacting the *Abitibi Act* created a unique set of facts that led to the orders being issued. The seizure of Abitibi's assets by the Province, the cancellation of all outstanding water and hydroelectric contracts between Abitibi and the Province, the cancellation of pending legal proceedings by Abitibi in which it sought the reimbursement of several hundreds of thousands of dollars, and the denial of any compensation for the seized assets and of legal redress are inescapable background facts in the judge's review of the *EPA* Orders.

51 The *CCAA* judge did not elaborate on whether it was sufficiently certain that the Minister would perform the remediation work and therefore make a monetary claim. However, most of his findings clearly rest on a positive answer to this question. For example, his finding that "[i]n all likelihood, the pith and substance of the EPA Orders is an attempt by the Province to lay the groundwork for monetary claims against Abitibi, to be used most probably as an offset in connection with Abitibi's own NAFTA claims for compensation" (para. 178), is necessarily based on the premise that the Province would most likely perform the remediation work. Indeed, since monetary claims must, both at common law and in civil law, be mutual for set-off or compensation to operate, the Province had to have incurred costs in doing the work in order to have a claim that could be set off against Abitibi's claims.

52 That the judge relied on an implicit finding that the Province would most likely perform the work and make a claim to offset its costs is also shown by the confirmation he found in the declaration by the Minister that the Province was attempting to assess the cost of doing remediation work Abitibi had allegedly left undone and that in the Province's assessment, "at this point in time, there would not be a net payment to Abitibi" (para. 181).

53 The *CCAA* judge's reasons not only rest on an implicit finding that the Province would most likely perform the work, but refer explicitly to facts that support this finding. To reach his conclusion that the *EPA* Orders were monetary in nature, the *CCAA* judge relied on the fact that Abitibi's operations were funded through debtor-in-possession financing and its access to funds was limited to ongoing operations. Given that the *EPA* Orders targeted sites that were, for the most part, no longer in Abitibi's possession, this meant that Abitibi had no means to perform the remediation work during the reorganization process.

54 In addition, because Abitibi lacked funds and no longer controlled the properties, the timetable set by the Province in the *EPA* Orders suggested that the Province never truly intended that Abitibi was to perform the remediation work required by the orders. The timetable was also unrealistic. For example, the orders were issued on November 12, 2009 and set a deadline of January 15, 2010 to perform a particular act, but the evidence revealed that compliance with this requirement would have taken close to a year.

55 Furthermore, the judge relied on the fact that Abitibi was not simply designated a "person responsible" under the *EPA*, but was intentionally targeted by the Province. The finding that the Province had targeted Abitibi was drawn not only from the timing of the *EPA* Orders, but also from the fact that Abitibi was the only person designated in them, whereas others also appeared to be responsible — in some cases, primarily responsible — for the contamination. For example, Abitibi was ordered to do remediation work on a site it had surrendered more than 50 years before the orders were issued; the expert report upon which the orders were based made no distinction between Abitibi's activities on

the property, on which its source of power had been horse power, and subsequent activities by others who had used fuelpowered vehicles there. In the judge's opinion, this finding of fact went to the Province's intent to establish a basis for performing the work itself and asserting a claim against Abitibi.

56 These reasons — and others — led the *CCAA* judge to conclude that the Province had not expected Abitibi to perform the remediation work and that the "intended, practical and realistic effect of the EPA Orders was to establish a basis for the Province to recover amounts of money to be eventually used for the remediation of the properties in question" (para. 211). He found that the Province appeared to have in fact taken some steps to liquidate the claims arising out of the *EPA* Orders.

57 In the end, the judge found that there was definitely a claim that "might" be filed, and that it was not left to "the subjective choice of the creditor to hold the claim in its pocket for tactical reasons" (para. 227). In his words, the situation did not involve a "detached regulator or public enforcer issuing [an] order for the public good" (at para. 175), and it was "the hat of a creditor that best [fit] the Province, not that of a disinterested regulator" (para. 176).

58 In sum, although the analytical framework used by Gascon J. was driven by the facts of the case, he reviewed all the legal principles and facts that needed to be considered in order to make the determination in the case at bar. He did at times rely on indicators that are unique and that do not appear in the analytical framework I propose above, but he did so because of the exceptional facts of this case. Yet, had he formulated the question in the same way as I have, his conclusion, based on his objective findings of fact, would have been the same. Earmarking money may be a strong indicator that a province will perform remediation work, and actually commencing the work is the first step towards the creation of a debt, but these are not the only considerations that can lead to a finding that a creditor has a monetary claim. The *CCAA* judge's assessment of the facts, particularly his finding that the *EPA* Orders were the first step towards performance of the remediation work by the Province, leads to no conclusion other than that it was sufficiently certain that the Province would perform remediation work and therefore fall within the definition of a creditor with a monetary claim.

VI. Conclusion

59 In sum, I agree with the Chief Justice that, as a general proposition, an environmental order issued by a regulatory body can be treated as a contingent claim, and that such a claim can be included in the claims process if it is sufficiently certain that the regulatory body will make a monetary claim against the debtor. Our difference of views lies mainly in the applicable threshold for including contingent claims and in our understanding of the *CCAA* judge's findings of fact.

60 With respect to the law, the Chief Justice would craft a standard specific to the context of environmental orders by requiring a "likelihood approaching certainty" that the regulatory body will perform the remediation work. She finds that this threshold is justified because "remediation may cost a great deal of money" (para. 22). I acknowledge that remediating pollution is often costly, but I am of the view that Parliament has borne this consideration in mind in enacting provisions specific to environmental claims. Moreover, I recall that in this case, the Premier announced that the remediation work would be performed at no net cost to the Province. It was clear to him that the *Abitibi Act* would make it possible to offset all the related costs.

61 Thus, I prefer to take the approach generally taken for all contingent claims. In my view, the *CCAA* court is entitled to take all relevant facts into consideration in making the relevant determination. Under this approach, the contingency to be assessed in a case such as this is whether it is sufficiently certain that the regulatory body will perform remediation work and be in a position to assert a monetary claim.

62 Finally, the Chief Justice would review the *CCAA* court's findings of fact. I would instead defer to them. On those findings, applying any legal standard, be it the one proposed by the Chief Justice or the one I propose, the Province's claim is monetary in nature and its motion for a declaration exempting the *EPA* Orders from the claims procedure order was properly dismissed.

63 For these reasons, I would dismiss the appeal with costs.

***McLachlin C.J.C.* (dissenting):**

1. Overview

64 The issue in this case is whether orders made under the *Environmental Protection Act*, S.N.L. 2002, c. E-14.2 ("*EPA*") by the Newfoundland and Labrador Minister of Environment and Conservation (the "Minister") requiring a polluter to clean up sites (the "*EPA* Orders") are monetary claims that can be compromised in corporate restructuring under the *Companies' Creditors Arrangement Act*, R.S.C. 1985, c. C-36 ("*CCAA*"). If they are not claims that can be compromised in restructuring, the Abitibi respondents ("Abitibi") will still have a legal obligation to clean up the sites following their emergence from restructuring. If they are such claims, Abitibi will have emerged from restructuring free of the obligation, able to recommence business without remediating the properties it polluted, the cost of which will fall on the Newfoundland and Labrador public.

65 Remediation orders made under a province's environmental protection legislation impose ongoing regulatory obligations on the corporation required to clean up the pollution. They are not monetary claims. In narrow circumstances, specified by the *CCAA*, these ongoing regulatory obligations may be reduced to monetary claims, which can be compromised under *CCAA* proceedings. This occurs where a province has done the work, or where it is "sufficiently certain" that it will do the work. In these circumstances, the regulatory obligation would be extinguished and the province would have a monetary claim for the cost of remediation in the *CCAA* proceedings. Otherwise, the regulatory obligation survives the restructuring.

66 In my view, the orders for remediation in this case, with a minor exception, are not claims that can be compromised in restructuring. On one of the properties, the Minister did emergency remedial work and put other work out to tender. These costs can be claimed in the *CCAA* proceedings. However, with respect to the other properties, on the evidence before us, the Minister has neither done the clean-up work, nor is it sufficiently certain that he or she will do so. The Province of Newfoundland and Labrador (the "Province") retained a number of options, including requiring Abitibi to perform the remediation if it successfully emerged from the *CCAA* restructuring.

67 I would therefore allow the appeal and grant the Province the declaration it seeks that Abitibi is still subject to its obligations under the *EPA* following its emergence from restructuring, except for work done or tendered for on the Buchans site.

2. The Proceedings Below

68 The *CCAA* judge took the view that the Province issued the *EPA* Orders, not in order to make Abitibi remediate, but as part of a money grab. He therefore concluded that the orders were monetary and financial in nature and should be considered claims that could be compromised under the *CCAA* (2010 QCCS 1261, 68 C.B.R. (5th) 1 (C.S. Que.)). The Quebec Court of Appeal denied leave to appeal on the ground that this "factual" conclusion could not be disturbed (2010 QCCA 965, 68 C.B.R. (5th) 57 (C.A. Que.)).

69 The *CCAA* judge's stark view that an *EPA* obligation can be considered a monetary claim capable of being compromised simply because (as he saw it) the Province's motive was money, is no longer pressed. Whether an *EPA* order is a claim under the *CCAA* depends on whether it meets the requirements for a claim under that statute. That is the only issue to be resolved. Insofar as this determination touches on the division of powers, I am in substantial agreement with my colleague Deschamps J., at paras. 18-19.

3. The Distinction Between Regulatory Obligations and Claims under the CCAA

70 Orders to clean up polluted property under provincial environmental protection legislation are regulatory orders. They remain in effect until the property has been cleaned up or the matter otherwise resolved.

71 It is not unusual for corporations seeking to restructure under the *CCAA* to be subject to a variety of ongoing regulatory orders arising from statutory schemes governing matters like employment, energy conservation and the environment. The corporation remains subject to these obligations as it continues to carry on business during the restructuring period, and remains subject to them when it emerges from restructuring unless they have been compromised or liquidated.

72 The *CCAA*, like the *Bankruptcy and Insolvency Act*, R.S.C. 1985, c. B-3 ("*BIA*") draws a fundamental distinction between ongoing regulatory obligations owed to the public, which generally survive the restructuring, and monetary claims that can be compromised.

73 This distinction is also recognized in the jurisprudence, which has held that regulatory duties owed to the public are not "claims" under the *BIA*, nor, by extension, under the *CCAA*. In *Panamericana de Bienes y Servicios S.A. v. Northern Badger Oil & Gas Ltd.* (1991), 81 Alta. L.R. (2d) 45 (Alta. C.A.), the Alberta Court of Appeal held that a receiver in bankruptcy must comply with an order from the Energy Resources Conservation Board to comply with well abandonment requirements. Writing for the court, Laycraft C.J.A. said the question was whether the *Bankruptcy Act* "requires that the assets in the estate of an insolvent well licensee should be distributed to creditors leaving behind the duties respecting environmental safety ... as a charge to the public" (para. 29). He answered the question in the negative:

> The duty is owed as a public duty by all the citizens of the community to their fellow citizens. When the citizen subject to the order complies, the result is not the recovery of money by the peace officer or public authority, or of a judgement for money, nor is that the object of the whole process. Rather, it is simply the enforcement of the general law. The enforcing authority does not become a "creditor" of the citizen on whom the duty is imposed.
>
> [Emphasis added, para. 33]

74 The distinction between regulatory obligations under the general law aimed at the protection of the public and monetary claims that can be compromised in *CCAA* restructuring or bankruptcy is a fundamental plank of Canadian corporate law. It has been repeatedly acknowledged: *Lamford Forest Products Ltd. (Re)* (1991), 86 D.L.R. (4th) 534 (B.C. S.C.); *Shirley, Re* (1995), 129 D.L.R. (4th) 105 (Ont. Bktcy.)), at p. 109; *Husky Oil Operations Ltd. v. Minister of National Revenue*, [1995] 3 S.C.R. 453 (S.C.C.), at para. 146, *per* Iacobucci J. (dissenting). As Farley J. succinctly put it in *Air Canada Re [Regulators' motions]*, (2003), 28 C.B.R. (5th) 52 (Ont. S.C.J. [Commercial List]), at para. 18: "Once [the company] emerges from these CCAA proceedings (successfully one would hope), then it will have to deal with each and every then unresolved [regulatory] matter."

75 Recent amendments to the *CCAA* confirm this distinction. Section 11.1(2) now explicitly provides that, except to the extent a regulator is enforcing a payment obligation, a general stay does not affect a regulatory body's authority in relation to a corporation going through restructuring. The *CCAA* court may only stay specific actions or suits brought by a regulatory body, and only if such action is necessary for a viable compromise to be reached and it would not be contrary to the public interest to make such an order (s. 11.1(3)).

76 Abitibi argues that another amendment to the *CCAA*, s. 11.8(9), treats ongoing regulatory duties owed to the public as claims, and erases the distinction between the two types of obligation: see *General Chemical Canada Ltd., Re*, 2007 ONCA 600, 228 O.A.C. 385 (Ont. C.A.), *per* Goudge J.A., relying on s. 14.06(8) of the *BIA* (the equivalent of s. 11.8(9) of the *CCAA*). With respect, this reads too much into the provision. Section 11.8(9) of the *CCAA* refers only to the situation where a government has performed remediation, and provides that the *costs of the remediation* become a claim in the restructuring process even where the environmental damage arose after *CCAA* proceedings have begun. As stated in *Strathcona (County) v. Fantasy Construction Ltd. Estate (Trustee of)*, 2005 ABQB 559, 47 Alta. L.R. (4th) 138 (Alta. Q.B.), *per* Burrows J., the section "does not convert a statutorily imposed obligation owed to the public at large into a liability owed to the public body charged with enforcing it" (para. 42).

4. When Does a Regulatory Obligation Become a Claim Under the CCAA?

77 This brings us to the heart of the question before us: when does a regulatory obligation imposed on a corporation under environmental protection legislation become a "claim" provable and compromisable under the *CCAA*?

78 Regulatory obligations are, as a general proposition, not compromisable claims. Only financial or monetary claims provable by a "creditor" fall within the definition of "claim" under the *CCAA*. "Creditor" is defined as "a person having a claim ..." (*BIA* s. 2). Thus, the identification of a "creditor" hangs on the existence of a "claim". Section 12(1) of the *CCAA* defines "claim" as "any indebtedness, liability or obligation ... that ... would be a debt provable in bankruptcy", which is accepted as confined to obligations of a financial or monetary nature.

79 The *CCAA* does not depart from the proposition that a claim must be financial or monetary. However, it contains a scheme to deal with disputes over whether an obligation is a monetary obligation as opposed to some other kind of obligation.

80 Such a dispute may arise with respect to environmental obligations of the corporation. The *CCAA* recognizes three situations that may arise when a corporation enters restructuring.

81 The first situation is where the remedial work has not been done (and there is no "sufficient certainty" that the work will be done, unlike the third situation described below). In this situation, the government cannot claim the cost of remediation: see s. 102(3) of the *EPA*. The obligation of compliance falls in principle on the monitor who takes over the corporation's assets and operations. If the monitor remediates the property, he can claim the costs as costs of administration. If he does not wish to do so, he may obtain a court order staying the remediation obligation or abandon the property: s. 11.8(5) *CCAA* (in which case costs of remediation shall not rank as costs of administration: s. 11.8(7)). In this situation, the obligation cannot be compromised.

82 The second situation is where the government that has issued the environmental protection order moves to clean up the pollution, as the legislation entitles it to do. In this situation, the government has a claim for the cost of remediation that is compromisable in the *CCAA* proceedings. This is because the government, by moving to clean up the pollution, has changed the outstanding regulatory obligation owed to the public into a financial or monetary obligation owed by the corporation to the government. Section 11.8(9), already discussed, makes it clear that this applies to damage after the *CCAA* proceedings commenced, which might otherwise not be claimable as a matter of timing.

83 A third situation may arise: the government has not yet performed the remediation at the time of restructuring, but there is "sufficient certainty" that it will do so. This situation is regulated by the provisions of the *CCAA* for contingent or future claims. Under the *CCAA*, a debt or liability that is contingent on a future event may be compromised.

84 It is clear that a mere possibility that work will be done does not suffice to make a regulatory obligation a contingent claim under the *CCAA*. Rather, there must be "sufficient certainty" that the obligation will be converted into a financial or monetary claim to permit this. The impact of the obligation on the insolvency process is irrelevant to the analysis of contingency. The future liabilities must not be "so remote and speculative in nature that they could not properly be considered contingent claims": *Confederation Treasury Services Ltd. (Bankrupt) Re* (1997), 96 O.A.C. 75 (Ont. C.A.) (para. 4).

85 Where environmental obligations are concerned, courts to date have relied on a high degree of probability verging on certainty that the government will in fact step in and remediate the property. In *Anvil Range Mining Corp., Re* (2001), 25 C.B.R. (4th) 1 (Ont. S.C.J. [Commercial List]), Farley J. concluded that a contingent claim was established where the money had already been earmarked in the budget for the remediation project. He observed that "there appears to be *every likelihood to a certainty* that every dollar in the budget for the year ending March 31, 2002 earmarked for reclamation will be spent" (para. 15 (emphasis added)). Similarly, in *Shirley, Re*, Kennedy J. relied on the fact that the Ontario Minister of Environment had already entered the property at issue and commenced remediation activities to conclude that "[a]ny doubt about the resolve of the MOE's intent to realize upon its authority ended when it began to incur expense from operations" (p. 110).

86 There is good reason why "sufficient certainty" should be interpreted as requiring "likelihood approaching certainty" when the issue is whether ongoing environmental obligations owed to the public should be converted to contingent claims that can be expunged or compromised in the restructuring process. Courts should not overlook the obstacles governments may encounter in deciding to remediate environmental damage a corporation has caused. To begin with, the government's decision is discretionary and may be influenced by any number of competing political and social considerations. Furthermore, remediation may cost a great deal of money. For example, in this case, the *CCAA* court found that at a minimum the remediation would cost in the "mid-to-high eight figures" (at para. 81), and could indeed cost several times that. In concrete terms, the remediation at issue in this case may be expected to meet or exceed the entire budget of the Minister ($65 million) for 2009. Not only would this be a massive expenditure, but it would also likely require the specific approval of the Legislature and thereby be subject to political uncertainties. To assess these factors and determine whether all this will occur would embroil the *CCAA* judge in social, economic and political considerations — matters which are not normally subject to judicial consideration: *Knight v. Imperial Tobacco Canada Ltd.*, 2011 SCC 42, [2011] 3 S.C.R. 45 (S.C.C.), at para. 74. It is small wonder, then, that courts assessing whether it is "sufficiently certain" that a government will clean up pollution created by a corporation have insisted on proof of likelihood approaching certainty.

87 In this case, as will be seen, apart from the Buchans property, the record is devoid of any evidence capable of establishing that it is "sufficiently certain" that the Province will itself remediate the properties. Even on a more relaxed standard than the one adopted in similar cases to date, the evidence in this case would fail to establish that remediation is "sufficiently certain".

5. The Result in this Case

88 Five different sites are at issue in this case. The question in each case is whether the Minister has already remediated the property (making it to that extent an actual claim), or if not, whether it is "sufficiently certain" that he or she will remediate the property, permitting it to be considered a contingent claim.

89 The Buchans site posed immediate risks to human health as a consequence of high levels of lead and other contaminants in the soil, groundwater, surface water and sediment. There was a risk that the wind would disperse the contamination, posing a threat to the surrounding population. Lead has been found in residential areas of Buchans and adults tested in the town had elevated levels of lead in their blood. In addition, a structurally unsound dam at the Buchans site raised the risk of contaminating silt entering the Exploits and Buchans rivers.

90 The Minister quickly moved to address the immediate concern of the unsound dam and put out a request for tenders for other measures that required immediate action at the Buchans site. Money expended is clearly a claim under the *CCAA*. I am also of the view that the work for which the request for tenders was put out meets the "sufficiently certain" standard and constitutes a contingent claim.

91 Beyond this, it has not been shown that it is "sufficiently certain" that the Province will do the remediation work to permit Abitibi's ongoing regulatory obligations under the *EPA* Orders to be considered contingent debts. The same applies to the other properties, on which no work has been done and no requests for tender to do the work initiated.

92 Far from being "sufficiently certain", there is simply nothing on the record to support the view that the Province will move to remediate the remaining properties. It has not been shown that the contamination poses immediate health risks, which must be addressed without delay. It has not been shown that the Province has taken any steps to do any work. And it has not been shown that the Province has set aside or even contemplated setting aside money for this work. Abitibi relies on a statement by the then-Premier in discussing the possibility that the Province would be obliged to compensate Abitibi for expropriation of some of the properties, to the effect that "there would not be a net payment to Abitibi" (R.F. at para. 12). Apart from the fact that the Premier was not purporting to state government policy, the statement simply

does not say that the Province would do the remediation. The Premier may have simply been suggesting that outstanding environmental liabilities made the properties worth little or nothing, obviating any net payment to Abitibi.

93 My colleague Deschamps J. concludes that the findings of the *CCAA* court establish that it was "sufficiently certain" that the Province would remediate the land, converting Abitibi's regulatory obligations under the *EPA* Orders to contingent claims that can be compromised under the *CCAA*. With respect, I find myself unable to agree.

94 The *CCAA* judge never asked himself the critical question of whether it was "sufficiently certain" that the Province would do the work itself. Essentially, he proceeded on the basis that the *EPA* Orders had not been put forward in a sincere effort to obtain remediation, but were simply a money grab. The *CCAA* judge buttressed his view that the Province's regulatory orders were not sincere by opining that the orders were unenforceable (which if true would not prevent new *EPA* orders) and by suggesting that the Province did not want to assert a contingent claim, since this might attract a counterclaim by Abitibi for the expropriation of the properties (something that may be impossible due to Abitibi's decision to take the expropriation issue to NAFTA (the *North American Free Trade Agreement Between the Government of the United Mexican States and the Government of the United States of America*, Can.T.S. 1994 No. 2), excluding Canadian courts.) In any event, it is clear that the *CCAA* judge, on the reasoning he adopted, never considered the question of whether it was "sufficiently certain" that the Province would remediate the properties. It follows that the *CCAA* judge's conclusions cannot support the view that the outstanding obligations are contingent claims under the *CCAA*.

95 My colleague concludes:

> [The *CCAA* judge] did at times rely on indicators that are unique and that do not appear in the analytical framework I propose above, but he did so because of the exceptional facts of this case. Yet, had he formulated the question in the same way as I have, his conclusion, based on his objective findings of fact would have been same. ... The *CCAA* judge's assessment of the facts ... leads to no conclusion other than that it was sufficiently certain that the Province would perform remediation work and therefore fall within the definition of a creditor with a monetary claim.
>
> [Emphasis added, para. 58].

96 I must respectfully confess to a less sanguine view. First, I find myself unable to decide the case on what I think the *CCAA* judge would have done had he gotten the law right and considered the central question. In my view, his failure to consider that question requires this Court to answer it in his stead on the record before us: *Housen v. Nikolaisen*, 2002 SCC 33, [2002] 2 S.C.R. 235 (S.C.C.), at para. 35. But more to the point, I see no objective facts that support, much less compel, the conclusion that it is "sufficiently certain" that the Province will move to itself remediate any or all of the pollution Abitibi caused. The mood of the regulator in issuing remediation orders, be it disinterested or otherwise, has no bearing on the likelihood that the Province will undertake such a massive project itself. The Province has options. It could, to be sure, opt to do the work. Or it could await the result of Abitibi's restructuring and call on it to remediate once it resumed operations. It could even choose to leave the site contaminated. There is nothing in the record that makes the first option more probable than the others, much less establishes "sufficient certainty" that the Province will itself clean up the pollution, converting it to a debt.

97 I would allow the appeal and issue a declaration that Abitibi's remediation obligations under the *EPA* Orders do not constitute claims compromisable under the *CCAA*, except for work done or tendered for on the Buchans site.

***LeBel J.* (dissenting):**

98 I have read the reasons of the Chief Justice and Deschamps J. They agree that a court overseeing a proposed arrangement under the *Companies' Creditors Arrangement Act*, R.S.C. 1985, c. C-36 ("*CCAA*"), cannot relieve debtors of their regulatory obligations. The only regulatory orders that can be subject to compromise are those which are monetary in nature. My colleagues also accept that contingent environmental claims can be liquidated and compromised if it

is established that the regulatory body would remediate the environmental contamination itself, and hence turn the regulatory order into a monetary claim.

99 At this point, my colleagues disagree on the proper evidentiary test with respect to whether the government would remediate the contamination. In the Chief Justice's opinion, the evidence must show that there is a "likelihood approaching certainty" that the province would remediate the contamination itself (para. 22). In my respectful opinion, this is not the established test for determining where and how a contingent claim can be liquidated in bankruptcy and insolvency law. The test of "sufficient certainty" described by Deschamps J., which does not look very different from the general civil standard of probability, better reflects how both the common law and the civil law view and deal with contingent claims. On the basis of the test Deschamps J. proposes, I must agree with the Chief Justice and would allow the appeal.

100 First, no matter how I read the *CCAA* court's judgment (2010 QCCS 1261, 68 C.B.R. (5th) 1 (C.S. Que.)), I find no support for a conclusion that it is consistent with the principle that the *CCAA* does not apply to purely regulatory obligations, or that the court had evidence that would satisfy the test of "sufficient certainty" that the province of Newfoundland and Labrador (the "Province") would perform the remedial work itself.

101 In my view, the *CCAA* court was concerned that the arrangement would fail if the Abitibi respondents ("Abitibi") were not released from their regulatory obligations in respect of pollution. The *CCAA* court wanted to eliminate the uncertainty that would have clouded the reorganized corporations' future. Moreover, its decision appears to have been driven by an opinion that the Province had acted in bad faith in its dealings with Abitibi both during and after the termination of its operations in the Province. I agree with the Chief Justice that there is no evidence that the Province intends to perform the remedial work itself. In the absence of any other evidence, an off-hand comment made in the legislature by a member of the government hardly satisfies the "sufficient certainty" test. Even if the evidentiary test proposed by my colleague Deschamps J. is applied, this Court can legitimately disregard the *CCAA* court's finding as the Chief Justice proposes, since it did not rest on a sufficient factual foundation.

102 For these reasons, I would concur with the disposition proposed by the Chief Justice.

Appeal dismissed.

Pourvoi rejeté.

TAB 4

2005 CarswellOnt 2516
Ontario Court of Appeal

Ivorylane Corp. v. Country Style Realty Ltd.

2005 CarswellOnt 2516, [2005] O.J. No. 2535, 11 C.B.R. (5th) 230, 140 A.C.W.S. (3d) 16, 199 O.A.C. 1, 256 D.L.R. (4th) 38, 7 B.L.R. (4th) 15

Ivorylane Corporation (Plaintiff / Respondent) and Country Style Realty Limited (Defendant / Appellant)

Borins, Blair, LaForme JJ.A.

Heard: May 4, 2005
Judgment: June 21, 2005 *
Docket: CA C42138

Proceedings: affirming *Ivorylane Corp. v. Country Style Realty Ltd.* (2004), 2004 CarswellOnt 2567 (Ont. S.C.J. [Commercial List])

Counsel: Arnold Zweig for Appellant
Alistair Riswick for Respondent

Subject: Insolvency; Property

Headnote

Bankruptcy and insolvency --- Proposal — Companies' Creditors Arrangement Act — Miscellaneous issues

Tenant leased premises from landlord — Tenant paid fixed monthly rent but not additional variable charges for insurance, taxes and maintenance — Tenant obtained protection order under Companies' Creditors Arrangement Act — Tenant elected not to repudiate lease with landlord — Claims procedure order was issued, but tenant did not send notice to landlord as required by it — Sanction order was issued after creditors approved plan of compromise — Landlord commenced action for unpaid arrears — Tenant's motion to determine if landlord's claim was barred by plan was resolved in favour of landlord — Motion judge found that landlord should not be penalized for not filing proof of claim in time required by plan, as tenant was in breach of obligation to notify landlord — Motion judge concluded landlord's claim was unaffected obligation and not barred by plan, which prevented only claims by affected creditors — Tenant appealed — Appeal dismissed — Motion judge was correct that provisions of plan and sanction order did not bar landlord's claim — Motion judge's finding that landlord should have been given notice as known creditor was well supported by record — Plan made it clear that lease that was not repudiated and had no written agreement to allow claim was unaffected obligation — Plan expressly compromised only affected claims and sanction order was clear that it was binding only on affected creditors — Landlord was entitled to bring claim.

Table of Authorities

Cases considered by *Blair J.A.*:

Blue Range Resource Corp., Re (2000), 2000 ABCA 285, 2000 CarswellAlta 1145, (sub nom. *Enron Canada Corp. v. National-Oilwell Canada Ltd.*) 193 D.L.R. (4th) 314, [2001] 2 W.W.R. 477, 271 A.R. 138, 234 W.A.C. 138, 87 Alta. L.R. (3d) 352 (Alta. C.A.) — referred to

Statutes 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. 20 — referred to

R. 21 — referred to

APPEAL by tenant from judgment reported at *Ivorylane Corp. v. Country Style Realty Ltd.* (2004), 2004 CarswellOnt 2567 (Ont. S.C.J. [Commercial List]), finding landlord's claim against tenant was not barred by *Companies' Creditors Arrangement Act*.

***Blair J.A.*:**

Outline

1 The primary issue on this appeal is whether, on the facts of this case, a pre-CCAA claim for arrears of rent under a lease may be asserted in full against the re-organized CCAA company after the CCAA proceedings have been completed, where the lease in question was not repudiated as part of those proceedings.

2 On December 13, 2001, Country Style Realty Limited sought and obtained court protection pursuant to the *Companies' Creditors Arrangement Act* R.S.C. 1985, Chapter 36, as amended (the "CCAA"). As a result, all pending and potential proceedings against it were stayed pending negotiation and approval of a plan of compromise or arrangement between the company and its creditors. At the time, Country Style was in arrears in the payment of the portion of its rent pertaining to adjusted taxes, maintenance and insurance ("TMI") respecting a fast-food retail outlet leased from Ivorylane Corporation and located near Shanty Bay, Ontario. The arrears amount to $146,892.12.

3 Country Style elected not to repudiate the Ivorylane lease, as it was entitled to do under the Initial CCAA Order. All amounts owing for rent since the effective date of the CCAA proceedings, including the TMI portion of the rent, have been paid.

4 Although there had been intermittent negotiations about the arrears of TMI in 1999, Ivorylane had taken no steps to enforce its claim before the CCAA proceedings were commenced. There is currently no dispute about the amount of the claim, however.

5 For reasons that are unclear on the record, Ivorylane's claim for rental arrears was not documented in Country Style's books. As a result, no direct notice was given to it of the CCAA proceeding and it did not see the notice that was published in the Globe and Mail on January 9 and 10, 2002, in accordance with a Claims Procedure Order (the "CPO") granted by Lax J. on January 7. In fact, Ivorylane did not become aware of the CCAA proceedings until March 6, 2002, when it received from Country Style a faxed response to a February 26 summary of TMI arrears that Ivorylane's counsel had forwarded. The March 6 letter advised Ivorylane that Country Style, and related companies, had commenced proceedings under the CCAA.

6 On March 7, 2002, Spence J. sanctioned and approved the Plan of Compromise that Country Style had negotiated with its creditors (the "Sanction Order"), and Country Style emerged from CCAA protection.

7 On October 4, 2002, Ivorylane commenced this action, seeking to recover $146,892.12, being the full amount of the TMI arrears up to December 31, 2001. Country Style defended on the grounds that the claim was barred by the terms of the Plan of Compromise and the Sanction Order in the CCAA proceedings. On a Rule 21 motion for the determination of a question of law, Cumming J. declared that the claim was not barred. [1] Country Style appeals that decision.

8 For the reasons that follow, I would dismiss the appeal.

The CCAA Proceedings

9 Under the Initial Order granted by Colin Campbell J. on December 13, 2001 (paragraph 8(f)), Country Style was entitled, but not required, to,

> . . . repudiate any lease . . . relating to any leased premises . . . on such terms as may be agreed upon between the Applicant and such Landlord, or failing such agreement, to deal with the consequences thereof in the Plan.

10 The effect of the CCAA stay of proceedings was to require a landlord to continue to honour the terms of a lease that was not repudiated, provided Country Style complied with its obligations under the lease on a going-forward basis. After consultation with the Monitor appointed under the Initial Order, Country Style decided not to repudiate the lease.

11 On February 7, 2002, Lax J. granted the Claims Procedure Order which required, amongst other things, that notice of the CPO be given by facsimile transmission, personal delivery, courier or pre-paid mail to each known existing creditor, and that the creditor be provided with a Proof of Claim and Instruction Letter. In addition, a Notice to Creditors was to be placed in the national edition of the Globe and Mail newspaper for two days, commencing January 9, 2002. As I have indicated, no such notice was sent to Ivorylane, and Ivorylane did not see the notice in the Globe and Mail.

12 The CPO established a claims bar date (ultimately set as February 11, 2002). Any creditor not submitting a Proof of Claim by that date was to be forever barred from asserting the claim and the claim would be extinguished. Unaware of the CCAA proceedings, Ivorylane submitted no such Proof of Claim.

13 After the usual series of negotiations and meetings of creditors, the Plan of Compromise proposed by Country Style was approved by the requisite vote of creditors. Spence J. granted the Sanction Order on March 7, 2002.

Analysis

14 The motion judge concluded that Ivorylane's pre-CCAA claim for arrears of rent was an Unaffected Obligation and not an Affected Unsecured Claim under the Plan of Compromise. Therefore, it was not compromised, released, extinguished or barred by the Plan or the Sanction Order and Ivorylane was entitled to bring this action. The motion judge also held that the Claims Bar Date in the Claims Procedure Order was not effective to preclude Ivorylane's claim because Ivorylane had not been give the requisite notice. In any event, even if the Claims Bar Date were operative against Ivorylane, the motion judge would have granted relief against the bar "in the exceptional circumstances, as [he found] to be present in the instant situation" (reasons, para. 47), based on the principles enunciated by the Alberta Court of Appeal in *Blue Range Resource Corp., Re*, 2000 ABCA 285 (Alta. C.A.) at para. 41.

15 As the motion judge noted, there are some seeming anomalies in this result. First, Ivorylane appears to be better off as a result of his Order than it would have been had it received notice and filed its Proof of Claim (as it says it would have done). This is because, in the claims process, Ivorylane would have received only the eight or nine cents on the dollar that all Affected Unsecured Creditors received from the Plan. Secondly — and perhaps more notably — the effect of the Order is to place a landlord, with an ordinary unsecured claim for pre-CCAA arrears of rent, but whose lease has not been repudiated, in a superior position to other landlords with exactly the same kind of claim but whose lease was repudiated, and, as well, to place the landlord in a superior position to all other creditors with similar unsecured

claims. This contravenes the basic insolvency principle that creditors are to be treated equally and rateably in accordance with their class.

16 It would take compelling and clear language in the Plan and Sanction Order to mandate such a result. However, the fate of a creditor's claim in a CCAA proceeding is governed by the provisions of the Plan negotiated and approved by the creditors, and by the Court Order sanctioning the arrangement and permitting the insolvent company to reemerge as a viable economic entity. Therein lies the explanation for the apparent anomalies, in the circumstances of this case. The motion judge was correct in holding that the provisions of this Plan and this Sanction Order did not compromise or bar Ivorylane's claim for pre-CCAA arrears of rent.

17 A review of the pertinent provisions of the Sanction Order and the Plan bear out this conclusion.

The Sanction Order

18 Paragraph 6 of the Sanction Order sanctions and approves the Plan pursuant to the CCAA. In other provisions the Order stipulates that,

> a) the Plan becomes effective and binds the Applicants and *the Affected Creditors* upon the Effective Date (para. 8); and,
>
> b) subject to the provisions of the Plan, "all obligations or agreements to which the Applicants are party as of the Effective Date *shall be and remain in full force and effect, unamended*" and the parties are obliged to perform, and prohibited from repudiating, their obligations thereunder by reasons (amongst other things) of the fact that the Applicants sought and obtained relief under the CCAA or that a reorganization has been implemented (para. 15)
>
> [emphasis added].

The Plan

19 What the Motions Judge referred to as "the chain of definitions in s. 1.1 of the Plan", and certain other provisions of the Plan, are also important for the disposition of the appeal. The following definitions are pertinent:

> "Affected Claim" means an Affected Unsecured Claim or an Affected Secured Claim . . .
>
> "Affected Creditor" means a holder of an Affected Claim.
>
> "Affected Unsecured Claim" means a Claim for which a Proof of Claim has been delivered, including the Claims of those Persons listed on Schedule "A" [2]
>
> "Affected Unsecured Creditor" means a holder of an Affected Unsecured Claim including, without limitation, a holder of a Landlord Claim
>
> "Claim" includes any right of a Person against one or more of the Applicants in connection with any indebtedness, liability or obligation of any kind whatsoever of one or more of the Applicants . . . whether liquidated, unliquidated, reduced to judgment, fixed, contingent, matured, unmatured, disputed, undisputed, legal, equitable, secured, unsecured, present, future, known or unknown . . . including without limitation, any claim arising from or caused by the repudiation by an Applicant of any contract, Lease or other agreement . . . For greater certainty, a "Claim" includes a Landlord Claim but does not include any right to payments of any creditor for the provision of goods and/or services to an Applicant on or after the Date of Filing. [3]

"Landlord Claim" means an Affected Unsecured Claim arising in respect of (i) a Landlord Repudiation Claim or (ii) a Lease or written agreement relating to a Lease in respect of which the Applicants have agreed that a Claim may be made in consideration of an amendment or variation of the terms of such Lease or agreement.

"Landlord Creditors" means Affected Unsecured Creditors holding Landlord Claims.

"Landlord Repudiation Claim" means the actual or prospective repudiation of a Lease where notice of repudiation of such Lease was given by an Applicant in accordance with the Initial Order and the Claim Procedure Order which shall be calculated, in the case of a repudiation, as the Rent payable by an Applicant to such Landlord for the 12 months following the delivery of the notice of repudiation (but not beyond the termination date under the relevant Lease), less any amounts paid or payable by any other Person to such Landlord under any lease entered into by such Landlord for such premises after receipt by the Landlord of such notice of repudiation.

"Unaffected Obligations" means those Claims listed on Schedule "B".

20 Schedule "B" to the Plan, entitled "Unaffected Obligations" includes, in subparagraph (f) the following:

Equipment, personal property and *real property leases* and other contracts *which have not been repudiated* or terminated as at the Subsequent Claims Bar Date *and in respect of which there has been no written agreement to allow a Claim*

[emphasis added]

21 Other provisions in the Plan that are relevant include:

Section 2.2 Persons Affected

This Plan provides for a coordinated restructuring and compromising of Affected Claims. This Plan will become effective on the Effective Date and shall be binding on and enure to the benefit of the Applicants and the Affected Creditors . . .

Section 2.3 Persons Not Affected

This Plan does not affect holders of Unaffected Obligations. . . [emphasis added]

Section 7.1 Contracts and Leases

Except as otherwise provided in the Plan, or in any contract, instrument, release, indenture or other agreement or document entered into in connection with the Plan, as of the Effective Date each *Applicant shall be deemed to have ratified each* executory contract and *unexpired lease to which it is a party, unless such contract or lease (a) was previously repudiated* or terminated by such Applicant, or (b) previously expired or terminated pursuant to its own terms. [emphasis added]

Lack of Notice and the Effect of the Claims Procedure Order

22 The motion judge found that Ivorylane should have been given formal notice of the claims procedure process because it was, or should have been, a "known existing creditor". This finding is well supported by the record, and I agree with it. However, on the wording of this Plan and Sanction Order, it does not follow that Ivorylane's claim should be treated as if it were an Affected Claim compromised by the Plan. This conclusion flows from the following analysis.

23 Ivorylane's claim for pre-CCAA arrears of rent is clearly a "Claim" as that term is defined in the Plan. The Claims Procedure Order requires that any person with an existing claim must file a Proof of Claim and provides that the claims of those who fail to do so are barred forever. An Accepted Unsecured Claim is a claim with respect to which a Proof of

Claim is filed, and such Claims are compromised by the Plan and the Sanction Order. On a non-contextual application of the CPO alone, then, it would appear that if Ivorylane had filed a Proof of Claim — as it says it would have done, had it received notice — the claim for pre-CCAA arrears would have become an Accepted Claim. The CPO cannot override the terms of the Plan and the Sanction Order, however, and in my opinion, the effect of the provisions of the Plan respecting Unaffected Obligations is to divest Ivorylane's claim of its apparent quality as an Accepted Claim because of the provisions of the Plan respecting Unaffected Obligations.

24 I note, parenthetically, that at best, if Ivorylane's Claim were an Affected Claim, Ivorylane would be entitled to recover no more than the same compromised amount of eight or nine cents on the dollar as were other unsecured creditors of its class. However, for the reasons explained below, the wording of this particular Plan of Compromise takes Ivorylane's claim for such arrears out of the Affected Claim category for the simple reason that Country Style's obligation to pay those arrears is an obligation under a non-repudiated lease and is, accordingly, an Unaffected Obligation not affected by or compromised by the Plan.

The Plan and Sanction Order

25 The fact that the negotiators and authors of the Plan felt compelled to specify that a "landlord claim" was included in an "affected unsecured claim" and that "landlord creditors" means "affected unsecured creditors holding Landlord Claims", lends support to the notion that other claims by landlords — such as claims for pre-CCAA arrears of rent — are not included as affected unsecured claims. This conclusion is bolstered, in my opinion, by other provisions in the Plan. First, the definition section and Schedule "B", to the Plan make it plain that a real property lease that has not been repudiated or terminated, and in respect of which there has been no written agreement to allow a claim, is an "Unaffected Obligation". The Plan by its express terms only compromises Affected Claims and only binds Affected Creditors (s. 2.2). The Plan does not affect holders of Unaffected Obligations (s. 2.3).

26 Moreover, except as otherwise provided in the Plan — and I cannot find anywhere in the Plan where it is "otherwise provided" — Country Style is "deemed to have ratified each . . . unexpired lease to which it is a party, unless such . . . lease (a) was previously repudiated or terminated . . . or, (b) previously expired or terminated pursuant to its own terms (s. 7.1). The Ivorylane lease does not fall within either of these exceptions. There is nothing in the Plan or the Sanction Order to suggest that Country Style is only deemed to have ratified that part of the lease that relates to Country Style's post-CCAA obligations.

27 Finally, as noted earlier in these reasons, the Sanction Order makes it clear that the Plan only binds Affected Creditors and that any agreement to which Country Style is a party as at the Effective Date — which would include the unrepudiated Ivorylane lease — "shall be and remain in full force and effect *unamended*" and that Country Style, as a party to that agreement, is obliged to perform it and prohibited from repudiating its obligations under the lease by reason of the fact that Country Style sought and obtained CCAA relief or that a reorganization has been implemented (Sanction Order, para. 15).

Disposition

28 Accordingly, I agree with the motion judge, on the particular facts of this case, that Ivorylane's pre-CCAA claim for arrears of rent is not compromised or barred by the Plan and Sanction Order. Ivorylane is entitled to bring the within action.

29 The appeal is therefore dismissed.

30 In accordance with the agreement of counsel, costs of the appeal are fixed in the amount of $6,500 all inclusive, payable to the respondent as the successful party.

Borins J.A.:

I agree.

LaForme J.A.:

I agree.

Appeal dismissed.

Footnotes

* A corrigendum issued by the court on June 21, 2005 has been incorporated herein.

1 A Rule 20 motion for summary judgment, that was brought at the same time, was dismissed.

2 Schedule "A" is a list of all the existing known affected unsecured creditors. Ivorylane is not on that list.

3 "Claim" is even more compendiously defined than quoted here. I have excerpted only the portions of the definition that appear to relate to the issues on the appeal.

TAB 5

2012 ONSC 3767
Ontario Superior Court of Justice [Commercial List]

Cinram International Inc., Re

2012 CarswellOnt 8413, 2012 ONSC 3767, 217 A.C.W.S. (3d) 11, 91 C.B.R. (5th) 46

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 Cinram International Inc., Cinram International Income Fund, CII Trust and The Companies Listed in Schedule "A" (Applicants)

Morawetz J.

Heard: June 25, 2012
Judgment: June 26, 2012
Docket: CV-12-9767-00CL

Counsel: Robert J. Chadwick, Melaney Wagner, Caroline Descours for Applicants
Steven Golick for Warner Electra-Atlantic Corp.
Steven Weisz for Pre-Petition First Lien Agent, Pre-Petition Second Lien Agent and DIP Agent
Tracy Sandler for Twentieth Century Fox Film Corporation
David Byers for Proposed Monitor, FTI Consulting Inc.

Subject: Insolvency

Headnote

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

C group of companies was replicator and distributor of CDs and DVDs with operational footprint across North America and Europe — C group experienced significant declines in revenue and EBITDA, and had insufficient funds to meet their immediate cash requirements as result of liquidity challenges — C group sought protection of Companies' Creditors Arrangement Act — C group brought application seeking initial order under Act, and relief including stay of proceedings against third party non-applicant; authorization to make pre-filing payments; and approval of certain Court-ordered charges over their assets relating to their DIP Financing, administrative costs, indemnification of their trustees, directors and officers, Key Employee Retention Plan, and consent consideration — Application granted — Applicants met all qualifications established for relief under Act — Charges referenced in initial order were approved — Relief requested in initial order was extensive and went beyond what court usually considers on initial hearing; however, in circumstances, requested relief was appropriate — Applicants spent considerable time reviewing their alternatives and did so in consultative manner with their senior secured lenders — Senior secured lenders supported application, notwithstanding that it was clear that they would suffer significant shortfall on their positions.

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

C group of companies was replicator and distributor of CDs and DVDs with operational footprint across North America and Europe — C group experienced significant declines in revenue and EBITDA, and had insufficient funds to meet their immediate cash requirements as result of liquidity challenges — C group brought application seeking initial order under Companies' Creditors Arrangement Act and other relief, including authorization for C International to act as foreign representative in within proceedings to seek recognition order under Chapter 15

of U.S. Bankruptcy Code on basis that Ontario, Canada was Centre of Main Interest (COMI) of applicants — Application granted on other grounds — It is function of receiving court, in this case, U.S. Bankruptcy Court for District of Delaware, to make determination on location of COMI and to determine whether present proceeding is foreign main proceeding for purposes of Chapter 15.

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

Stay against third party non-applicant — C group of companies was replicator and distributor of CDs and DVDs with operational footprint across North America and Europe — C group experienced significant declines in revenue and EBITDA, and had insufficient funds to meet their immediate cash requirements as result of liquidity challenges — C group sought protection of Companies' Creditors Arrangement Act — C LP was not applicant in proceedings; however, C LP formed part of C group's income trust structure with C Fund, ultimate parent of C group — C group brought application seeking initial order under Act, including stay of proceedings against C LP — Application granted — Applicants met all qualifications established for relief under Act — Charges referenced in initial order were approved — Relief requested in initial order was extensive and went beyond what court usually considers on initial hearing; however, in circumstances, requested relief was appropriate.

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Fraser Papers Inc., Re (2009), 2009 CarswellOnt 3658, 56 C.B.R. (5th) 194 (Ont. S.C.J. [Commercial List]) — referred to

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Statutes considered:

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s. 2 "insolvent person" — considered

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Chapter 15 — referred to

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

s. 2(1) "company" — considered

s. 2(1) "debtor company" — considered

s. 3(1) — considered

s. 3(2) — considered

s. 11 — considered

s. 11.2 [en. 1997, c. 12, s. 124] — considered

s. 11.2(1) [en. 1997, c. 12, s. 124] — considered

s. 11.2(2) [en. 1997, c. 12, s. 124] — considered

s. 11.2(4) [en. 1997, c. 12, s. 124] — considered

s. 11.4 [en. 1997, c. 12, s. 124] — considered

s. 11.51 [en. 2005, c. 47, s. 128] — considered

s. 11.52 [en. 2005, c. 47, s. 128] — considered

APPLICATION by group of debtor companies for initial order and other relief under *Companies' Creditors Arrangement Act*.

Morawetz J.:

1 Cinram International Inc. ("CII"), Cinram International Income Fund ("Cinram Fund"), CII Trust and the Companies listed in Schedule "A" (collectively, the "Applicants") brought this application seeking an initial order (the "Initial Order") pursuant to the *Companies' Creditors Arrangement Act* ("CCAA"). The Applicants also request that the court exercise its jurisdiction to extend a stay of proceedings and other benefits under the Initial Order to Cinram International Limited Partnership ("Cinram LP", collectively with the Applicants, the "CCAA Parties").

2 Cinram Fund, together with its direct and indirect subsidiaries (collectively, "Cinram" or the "Cinram Group") is a replicator and distributor of CDs and DVDs. Cinram has a diversified operational footprint across North America and Europe that enables it to meet the replication and logistics demands of its customers.

3 The evidentiary record establishes that Cinram has experienced significant declines in revenue and EBITDA, which, according to Cinram, are a result of the economic downturn in Cinram's primary markets of North America and Europe, which impacted consumers' discretionary spending and adversely affected the entire industry.

4 Cinram advises that over the past several years it has continued to evaluate its strategic alternatives and rationalize its operating footprint in order to attempt to balance its ongoing operations and financial challenges with its existing debt levels. However, despite cost reductions and recapitalized initiatives and the implementation of a variety of restructuring alternatives, the Cinram Group has experienced a number of challenges that has led to it seeking protection under the CCAA.

5 Counsel to Cinram outlined the principal objectives of these CCAA proceedings as:

(i) to ensure the ongoing operations of the Cinram Group;

(ii) to ensure the CCAA Parties have the necessary availability of working capital funds to maximize the ongoing business of the Cinram Group for the benefit of its stakeholders; and

(iii) to complete the sale and transfer of substantially all of the Cinram Group's business as a going concern (the "Proposed Transaction").

6 Cinram contemplates that these CCAA proceedings will be the primary court supervised restructuring of the CCAA Parties. Cinram has operations in the United States and certain of the Applicants are incorporated under the laws of the United States. Cinram, however, takes the position that Canada is the nerve centre of the Cinram Group.

7 The Applicants also seek authorization for Cinram International ULC ("Cinram ULC") to act as "foreign representative" in the within proceedings to seek a recognition order under Chapter 15 of the United States Bankruptcy Code ("Chapter 15"). Cinram advises that the proceedings under Chapter 15 are intended to ensure that the CCAA Parties are protected from creditor actions in the United States and to assist with the global implementation of the Proposed Transaction to be undertaken pursuant to these CCAA proceedings.

8 Counsel to the Applicants submits that the CCAA Parties are part of a consolidated business in Canada, the United States and Europe that is headquartered in Canada and operationally and functionally integrated in many significant respects. Cinram is one of the world's largest providers of pre-recorded multi-media products and related logistics services. It has facilities in North America and Europe, and it:

(i) manufactures DVDs, blue ray disks and CDs, and provides distribution services for motion picture studios, music labels, video game publishers, computer software companies, telecommunication companies and retailers around the world;

(ii) provides various digital media services through One K Studios, LLC; and

(iii) provides retail inventory control and forecasting services through Cinram Retail Services LLC (collectively, the "Cinram Business").

9 Cinram contemplates that the Proposed Transaction could allow it to restore itself as a market leader in the industry. Cinram takes the position that it requires CCAA protection to provide stability to its operations and to complete the Proposed Transaction.

10 The Proposed Transaction has the support of the lenders forming the steering committee with respect to Cinram's First Lien Credit Facilities (the "Steering Committee"), the members of which have been subject to confidentiality agreements and represent 40% of the loans under Cinram's First Lien Credit Facilities (the "Initial Consenting Lenders"). Cinram also anticipates further support of the Proposed Transaction from additional lenders under its credit facilities following the public announcement of the Proposed Transaction.

11 Cinram Fund is the direct or indirect parent and sole shareholder of all of the subsidiaries in Cinram's corporate structure. A simplified corporate structure of the Cinram Group showing all of the CCAA Parties, including the designation of the CCAA Parties' business segments and certain non-filing entities, is set out in the Pre-Filing Report of FTI Consulting Inc. (the "Monitor") at paragraph 13. A copy is attached as Schedule "B".

12 Cinram Fund, CII, Cinram International General Partner Inc. ("Cinram GP"), CII Trust, Cinram ULC and 1362806 Ontario Limited are the Canadian entities in the Cinram Group that are Applicants in these proceedings (collectively, the "Canadian Applicants"). Cinram Fund and CII Trust are both open-ended limited purpose trusts, established under

the laws of Ontario, and each of the remaining Canadian Applicants is incorporated pursuant to Federal or Provincial legislation.

13 Cinram (US) Holdings Inc. ("CUSH"), Cinram Inc., IHC Corporation ("IHC"), Cinram Manufacturing, LLC ("Cinram Manufacturing"), Cinram Distribution, LLC ("Cinram Distribution"), Cinram Wireless, LLC ("Cinram Wireless"), Cinram Retail Services, LLC ("Cinram Retail") and One K Studios, LLC ("One K") are the U.S. entities in the Cinram Group that are Applicants in these proceedings (collectively, the "U.S. Applicants"). Each of the U.S. Applicants is incorporated under the laws of Delaware, with the exception of One K, which is incorporated under the laws of California. On May 25, 2012, each of the U.S. Applicants opened a new Canadian-based bank account with J.P. Morgan.

14 Cinram LP is not an Applicant in these proceedings. However, the Applicants seek to have a stay of proceedings and other relief under the CCAA extended to Cinram LP as it forms part of Cinram's income trust structure with Cinram Fund, the ultimate parent of the Cinram Group.

15 Cinram's European entities are not part of these proceedings and it is not intended that any insolvency proceedings will be commenced with respect to Cinram's European entities, except for Cinram Optical Discs SAC, which has commenced insolvency proceedings in France.

16 The Cinram Group's principal source of long-term debt is the senior secured credit facilities provided under credit agreements known as the "First-Lien Credit Agreement" and the "Second-Lien Credit Agreement" (together with the First-Lien Credit Agreement, the "Credit Agreements").

17 All of the CCAA Parties, with the exception of Cinram Fund, Cinram GP, CII Trust and Cinram LP (collectively, the "Fund Entities"), are borrowers and/or guarantors under the Credit Agreements. The obligations under the Credit Agreements are secured by substantially all of the assets of the Applicants and certain of their European subsidiaries.

18 As at March 31, 2012, there was approximately $233 million outstanding under the First-Lien Term Loan Facility; $19 million outstanding under the First-Lien Revolving Credit Facilities; approximately $12 million of letter of credit exposure under the First-Lien Credit Agreement; and approximately $12 million outstanding under the Second-Lien Credit Agreement.

19 Cinram advises that in light of the financial circumstances of the Cinram Group, it is not possible to obtain additional financing that could be used to repay the amounts owing under the Credit Agreements.

20 Mr. John Bell, Chief Financial Officer of CII, stated in his affidavit that in connection with certain defaults under the Credit Agreements, a series of waivers was extended from December 2011 to June 30, 2012 and that upon expiry of the waivers, the lenders have the ability to demand immediate repayment of the outstanding amounts under the Credit Agreements and the borrowers and the other Applicants that are guarantors under the Credit Agreements would be unable to meet their debt obligations. Mr. Bell further stated that there is no reasonable expectation that Cinram would be able to service its debt load in the short to medium term given forecasted net revenues and EBITDA for the remainder of fiscal 2012, fiscal 2013, and fiscal 2014. The cash flow forecast attached to his affidavit indicates that, without additional funding, the Applicants will exhaust their available cash resources and will thus be unable to meet their obligations as they become due.

21 The Applicants request a stay of proceedings. They take the position that in light of their financial circumstances, there could be a vast and significant erosion of value to the detriment of all stakeholders. In particular, the Applicants are concerned about the following risks, which, because of the integration of the Cinram business, also apply to the Applicants' subsidiaries, including Cinram LP:

(a) the lenders demanding payment in full for money owing under the Credit Agreements;

(b) potential termination of contracts by key suppliers; and

(c) potential termination of contracts by customers.

22 As indicated in the cash flow forecast, the Applicants do not have sufficient funds available to meet their immediate cash requirements as a result of their current liquidity challenges. Mr. Bell states in his affidavit that the Applicants require access to Debtor-In-Possession ("DIP") Financing in the amount of $15 millions to continue operations while they implement their restructuring, including the Proposed Transaction. Cinram has negotiated a DIP Credit Agreement with the lenders forming the Steering Committee (the "DIP Lenders") through J.P. Morgan Chase Bank, NA as Administrative Agent (the "DIP Agent") whereby the DIP Lenders agree to provide the DIP Financing in the form of a term loan in the amount of $15 million.

23 The Applicants also indicate that during the course of the CCAA proceedings, the CCAA Parties intend to generally make payments to ensure their ongoing business operations for the benefit of their stakeholders, including obligations incurred prior to, on, or after the commencement of these proceedings relating to:

(a) the active employment of employees in the ordinary course;

(b) suppliers and service providers the CCAA Parties and the Monitor have determined to be critical to the continued operation of the Cinram business;

(c) certain customer programs in place pursuant to existing contracts or arrangements with customers; and

(d) inter-company payments among the CCAA Parties in respect of, among other things, shared services.

24 Mr. Bell states that the ability to make these payments relating to critical suppliers and customer programs is subject to a consultation and approval process agreed to among the Monitor, the DIP Agent and the CCAA Parties.

25 The Applicants also request an Administration Charge for the benefit of the Monitor and Moelis and Company, LLC ("Moelis"), an investment bank engaged to assist Cinram in a comprehensive and thorough review of its strategic alternatives.

26 In addition, the directors (and in the case of Cinram Fund and CII Trust, the Trustees, referred to collectively with the directors as the "Directors/Trustees") requested a Director's Charge to provide certainty with respect to potential personal liability if they continue in their current capacities. Mr. Bell states that in order to complete a successful restructuring, including the Proposed Transaction, the Applicants require the active and committed involvement of their Directors/Trustees and officers. Further, Cinram's insurers have advised that if Cinram was to file for CCAA protection, and the insurers agreed to renew the existing D&O policies, there would be a significant increase in the premium for that insurance.

27 Cinram has also developed a key employee retention program (the "KERP") with the principal purpose of providing an incentive for eligible employees, including eligible officers, to remain with the Cinram Group despite its financial difficulties. The KERP has been reviewed and approved by the Board of Trustees of the Cinram Fund. The KERP includes retention payments (the "KERP Retention Payments") to certain existing employees, including certain officers employed at Canadian and U.S. Entities, who are critical to the preservation of Cinram's enterprise value.

28 Cinram also advises that on June 22, 2012, Cinram Fund, the borrowers under the Credit Agreements, and the Initial Consenting Lenders entered into a support agreement pursuant to which the Initial Consenting Lenders agreed to support the Proposed Transaction to be pursued through these CCAA proceedings (the "Support Agreement").

29 Pursuant to the Support Agreement, lenders under the First-Lien Credit Agreement who execute the Support Agreement or Consent Agreement prior to July 10, 2012 (the "Consent Date") are entitled to receive consent

consideration (the "Early Consent Consideration") equal to 4% of the principal amount of loans under the First-Lien Credit Agreement held by such consenting lenders as of the Consent Date, payable in cash from the net sale proceeds of the Proposed Transaction upon distribution of such proceeds in the CCAA proceedings.

30 Mr. Bell states that it is contemplated that the CCAA proceedings will be the primary court-supervised restructuring of the CCAA Parties. He states that the CCAA Parties are part of a consolidated business in Canada, the United States and Europe that is headquartered in Canada and operationally and functionally integrated in many significant respects. Mr. Bell further states that although Cinram has operations in the United States, and certain of the Applicants are incorporated under the laws of the United States, it is Ontario that is Cinram's home jurisdiction and the nerve centre of the CCAA Parties' management, business and operations.

31 The CCAA Parties have advised that they will be seeking a recognition order under Chapter 15 to ensure that they are protected from creditor actions in the United States and to assist with the global implementation of the Proposed Transaction. Thus, the Applicants seek authorization in the Proposed Initial Order for:

> Cinram ULC to seek recognition of these proceedings as "foreign main proceedings" and to seek such additional relief required in connection with the prosecution of any sale transaction, including the Proposed Transaction, as well as authorization for the Monitor, as a court-appointed officer, to assist the CCAA Parties with any matters relating to any of the CCAA Parties' subsidiaries and any foreign proceedings commenced in relation thereto.

32 Mr. Bell further states that the Monitor will be actively involved in assisting Cinram ULC as the foreign representative of the Applicants in the Chapter 15 proceedings and will assist in keeping this court informed of developments in the Chapter 15 proceedings.

33 The facts relating to the CCAA Parties, the Cinram business, and the requested relief are fully set out in Mr. Bell's affidavit.

34 Counsel to the Applicants filed a comprehensive factum in support of the requested relief in the Initial Order. Part III of the factum sets out the issues and the law.

35 The relief requested in the form of the Initial Order is extensive. It goes beyond what this court usually considers on an initial hearing. However, in the circumstances of this case, I have been persuaded that the requested relief is appropriate.

36 In making this determination, I have taken into account that the Applicants have spent a considerable period of time reviewing their alternatives and have done so in a consultative manner with their senior secured lenders. The senior secured lenders support this application, notwithstanding that it is clear that they will suffer a significant shortfall on their positions. It is also noted that the Early Consent Consideration will be available to lenders under the First-Lien Credit Agreement who execute the Support Agreement prior to July 10, 2012. Thus, all of these lenders will have the opportunity to participate in this arrangement.

37 As previously indicated, the Applicants' factum is comprehensive. The submissions on the law are extensive and cover all of the outstanding issues. It provides a fulsome review of the jurisprudence in the area, which for purposes of this application, I accept. For this reason, paragraphs 41-96 of the factum are attached as Schedule "C" for reference purposes.

38 The Applicants have also requested that the confidential supplement — which contains the KERP summary listing the individual KERP Payments and certain DIP Schedules — be sealed. I am satisfied that the KERP summary contains individually identifiable information and compensation information, including sensitive salary information, about the individuals who are covered by the KERP and that the DIP schedules contain sensitive competitive information of the CCAA Parties which should also be treated as being confidential. Having considered the principals of *Sierra Club of*

Canada v. Canada (Minister of Finance), [2002] 2 S.C.R. 522 (S.C.C.), I accept the Applicants' submission on this issue and grant the requested sealing order in respect of the confidential supplement.

39 Finally, the Applicants have advised that they intend to proceed with a Chapter 15 application on June 26, 2012 before the United States Bankruptcy Court in the District of Delaware. I am given to understand that Cinram ULC, as proposed foreign representative, will be seeking recognition of the CCAA proceedings as "foreign main proceedings" on the basis that Ontario, Canada is the Centre of Main Interest or "COMI" of the CCAA Applicants.

40 In his affidavit at paragraph 195, Mr. Bell states that the CCAA Parties are part of a consolidated business that is headquartered in Canada and operationally and functionally integrated in many significant respects and that, as a result of the following factors, the Applicants submit the COMI of the CCAA Parties is Ontario, Canada:

> (a) the Cinram Group is managed on a consolidated basis out of the corporate headquarters in Toronto, Ontario, where corporate-level decision-making and corporate administrative functions are centralized;
>
> (b) key contracts, including, among others, major customer service agreements, are negotiated at the corporate level and created in Canada;
>
> (c) the Chief Executive Officer and Chief Financial Officer of CII, who are also directors, trustees and/or officers of other entities in the Cinram Group, are based in Canada;
>
> (d) meetings of the board of trustees and board of directors typically take place in Canada;
>
> (e) pricing decisions for entities in the Cinram Group are ultimately made by the Chief Executive Officer and Chief Financial Officer in Toronto, Ontario;
>
> (f) cash management functions for Cinram's North American entities, including the administration of Cinram's accounts receivable and accounts payable, are managed from Cinram's head office in Toronto, Ontario;
>
> (g) although certain bookkeeping, invoicing and accounting functions are performed locally, corporate accounting, treasury, financial reporting, financial planning, tax planning and compliance, insurance procurement services and internal audits are managed at a consolidated level in Toronto, Ontario;
>
> (h) information technology, marketing, and real estate services are provided by CII at the head office in Toronto, Ontario;
>
> (i) with the exception of routine maintenance expenditures, all capital expenditure decisions affecting the Cinram Group are managed in Toronto, Ontario;
>
> (j) new business development initiatives are centralized and managed from Toronto, Ontario; and
>
> (k) research and development functions for the Cinram Group are corporate-level activities centralized at Toronto, Ontario, including the Cinram Group's corporate-level research and development budget and strategy.

41 Counsel submits that the CCAA Parties are highly dependent upon the critical business functions performed on their behalf from Cinram's head office in Toronto and would not be able to function independently without significant disruptions to their operations.

42 The above comments with respect to the COMI are provided for informational purposes only. This court clearly recognizes that it is the function of the receiving court — in this case, the United States Bankruptcy Court for the District of Delaware — to make the determination on the location of the COMI and to determine whether this CCAA proceeding is a "foreign main proceeding" for the purposes of Chapter 15.

43 In the result, I am satisfied that the Applicants meet all of the qualifications established for relief under the CCAA and I have signed the Initial Order in the form submitted, which includes approvals of the Charges referenced in the Initial Order.

Schedule "A"

Additional Applicants

Cinram International General Partner Inc.

Cinram International ULC

1362806 Ontario Limited

Cinram (U.S.) Holdings Inc.

Cinram, Inc.

IHC Corporation

Cinram Manufacturing LLC

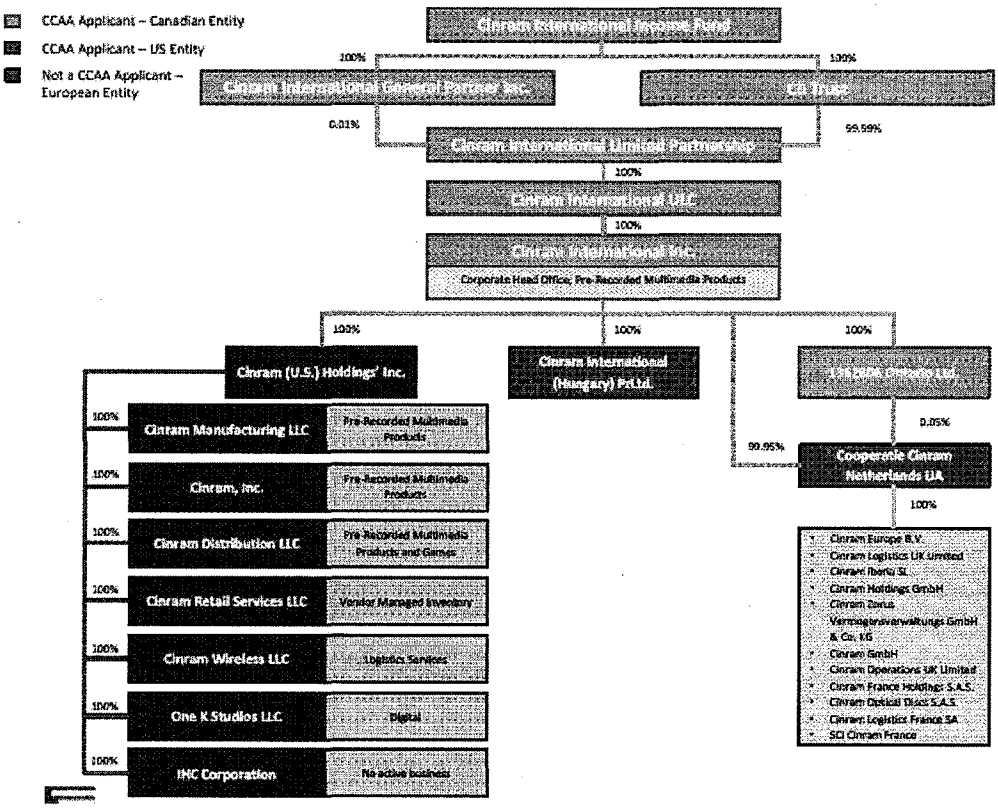
Cinram Distribution LLC

Cinram Wireless LLC

Cinram Retail Services, LLC

One K Studios, LLC

Schedule "B"



Graphic 1

Schedule "C"

A. The Applicants Are "Debtor Companies" to Which the CCAA Applies

41. The CCAA applies in respect of a "debtor company" (including a foreign company having assets or doing business in Canada) or "affiliated debtor companies" where the total of claims against such company or companies exceeds $5 million.

CCAA, Section 3(1).

42. The Applicants are eligible for protection under the CCAA because each is a "debtor company" and the total of the claims against the Applicants exceeds $5 million.

(1) The Applicants are Debtor Companies

43. The terms "company" and "debtor company" are defined in Section 2 of the CCAA as follows:

> "company" means any company, corporation or legal person incorporated by or under an Act of Parliament or of the legislature of a province and any incorporated company having assets or doing business in Canada, wherever incorporated, and any income trust, but does not include banks, authorized foreign banks within the meaning of section 2 of the *Bank Act*, railway or telegraph companies, insurance companies and companies to which the *Trust and Loan Companies Act* applies.
>
> "debtor company" means any company that:

(a) is bankrupt or insolvent;

(b) has committed an act of bankruptcy within the meaning of the *Bankruptcy and Insolvency Act* or is deemed insolvent within the meaning of the *Winding-Up and Restructuring Act*, whether or not proceedings in respect of the company have been taken under either of those Acts;

(c) has made an authorized assignment or against which a receiving order has been made under the *Bankruptcy and Insolvency Act*; or

(d) is in the course of being wound up under the *Winding-Up and Restructuring Act* because the company is insolvent.

CCAA, Section 2 ("company" and "debtor company").

44. The Applicants are debtor companies within the meaning of these definitions.

(2) The Applicants are "companies"

45. The Applicants are "companies" because:

a. with respect to the Canadian Applicants, each is incorporated pursuant to federal or provincial legislation or, in the case of Cinram Fund and CII Trust, is an income trust; and

b. with respect to the U.S. Applicants, each is an incorporated company with certain funds in bank accounts in Canada opened in May 2012 and therefore each is a company having assets or doing business in Canada.

Bell Affidavit at paras. 4, 80, 84, 86, 91, 94, 98, 102, 105, 108, 111, 114, 117, 120, 123, 212; Application Record, Tab 2.

46. The test for "having assets or doing business in Canada" is disjunctive, such that either "having assets" in Canada or "doing business in Canada" is sufficient to qualify an incorporated company as a "company" within the meaning of the CCAA.

47. Having only nominal assets in Canada, such as funds on deposit in a Canadian bank account, brings a foreign corporation within the definition of "company". In order to meet the threshold statutory requirements of the CCAA, an applicant need only be in technical compliance with the plain words of the CCAA.

Canwest Global Communications Corp., Re (2009), 59 C.B.R. (5th) 72 (Ont. S.C.J. [Commercial List]) at para. 30 [*Canwest Global*]; Book of Authorities of the Applicants ("*Book of Authorities*"), Tab 1.

Global Light Telecommunications Inc., Re (2004), 2 C.B.R. (5th) 210 (B.C. S.C.) at para. 17 [*Global Light*]; Book of Authorities, Tab 2.

48. The Courts do not engage in a quantitative or qualitative analysis of the assets or the circumstances in which the assets were created. Accordingly, the use of "instant" transactions immediately preceding a CCAA application, such as the creation of "instant debts" or "instant assets" for the purposes of bringing an entity within the scope of the CCAA, has received judicial approval as a legitimate device to bring a debtor within technical requirements of the CCAA.

Global Light Telecommunications Inc., Re, supra at para. 17; Book of Authorities, Tab 2.

Cadillac Fairview Inc., Re (1995), 30 C.B.R. (3d) 29 (Ont. Gen. Div. [Commercial List]) at paras. 5-6; Book of Authorities, Tab 3.

Nova Metal Products Inc. v. Comiskey (Trustee of) (1990), 1 O.R. (3d) 289 (Ont. C.A.) at paras. 74, 83; Book of Authorities, Tab 4.

(3) The Applicants are insolvent

49. The Applicants are "debtor companies" as defined in the CCAA because they are companies (as set out above) and they are insolvent.

50. The insolvency of the debtor is assessed as of the time of filing the CCAA application. The CCAA does not define insolvency. Accordingly, in interpreting the meaning of "insolvent", courts have taken guidance from the definition of "insolvent person" in Section 2(1) of the *Bankruptcy and Insolvency Act* (the "BIA"), which defines an "insolvent person" as a person (i) who is not bankrupt; and (ii) who resides, carries on business or has property in Canada; (iii) whose liabilities to creditors provable as claims under the BIA amount to one thousand dollars; and (iv) who is "insolvent" under one of the following tests:

a. is for any reason unable to meet his obligations as they generally become due;

b. has ceased paying his current obligations in the ordinary course of business as they generally become due; or

c. the aggregate of his property is not, at a fair valuation, sufficient, or if disposed of at a fairly conducted sale under legal process, would not be sufficient to enable payment of all his obligations, due and accruing due.

BIA, Section 2 ("insolvent person").

Stelco Inc., Re (2004), 48 C.B.R. (4th) 299 (Ont. S.C.J. [Commercial List]); leave to appeal to C.A. refused [2004] O.J. No. 1903 (Ont. C.A.); leave to appeal to S.C.C. refused [2004] S.C.C.A. No. 336 (S.C.C.), at para.4 [*Stelco*]; Book of Authorities, Tab 5.

51. These tests for insolvency are disjunctive. A company satisfying any one of these tests is considered insolvent for the purposes of the CCAA.

Stelco Inc., Re, supra at paras. 26 and 28; Book of Authorities, Tab 5.

52. A company is also insolvent for the purposes of the CCAA if, at the time of filing, there is a reasonably foreseeable expectation that there is a looming liquidity condition or crisis that would result in the company being unable to pay its debts as they generally become due if a stay of proceedings and ancillary protection are not granted by the court.

Stelco Inc., Re, supra at para. 40; Book of Authorities, Tab 5.

53. The Applicants meet both the traditional test for insolvency under the BIA and the expanded test for insolvency based on a looming liquidity condition as a result of the following:

a. The Applicants are unable to comply with certain financial covenants under the Credit Agreements and have entered into a series of waivers with their lenders from December 2011 to June 30, 2012.

b. Were the Lenders to accelerate the amounts owing under the Credit Agreements, the Borrowers and the other Applicants that are Guarantors under the Credit Agreements would be unable to meet their debt obligations. Cinram Fund would be the ultimate parent of an insolvent business.

d. The Applicants have been unable to repay or refinance the amounts owing under the Credit Agreements or find an out-of-court transaction for the sale of the Cinram Business with proceeds that equal or exceed the amounts owing under the Credit Agreements.

e. Reduced revenues and EBITDA and increased borrowing costs have significantly impaired Cinram's ability to service its debt obligations. There is no reasonable expectation that Cinram will be able to service its debt load in the short to medium term given forecasted net revenues and EBITDA for the remainder of fiscal 2012 and for fiscal 2013 and 2014.

f. The decline in revenues and EBITDA generated by the Cinram Business has caused the value of the Cinram Business to decline. As a result, the aggregate value of the Property, taken at fair value, is not sufficient to allow for payment of all of the Applicants' obligations due and accruing due.

g. The Cash Flow Forecast indicates that without additional funding the Applicants will exhaust their available cash resources and will thus be unable to meet their obligations as they become due.

Bell Affidavit, paras. 23, 179-181, 183, 197-199; Application Record, Tab 2.

(4) The Applicants are affiliated companies with claims outstanding in excess of $5 million

54. The Applicants are affiliated debtor companies with total claims exceeding 5 million dollars. Therefore, the CCAA applies to the Applicants in accordance with Section 3(1).

55. Affiliated companies are defined in Section 3(2) of the CCAA as follows:

a. companies are affiliated companies if one of them is the subsidiary of the other or both are subsidiaries of the same company or each is controlled by the same person; and

b. two companies are affiliated with the same company at the same time are deemed to be affiliated with each other.

CCAA, Section 3(2).

56. CII, CII Trust and all of the entities listed in Schedule "A" hereto are indirect, wholly owned subsidiaries of Cinram Fund; thus, the Applicants are "affiliated companies" for the purpose of the CCAA.

Bell Affidavit, paras. 3, 71; Application Record, Tab 2.

57. All of the CCAA Parties (except for the Fund Entities) are each a Borrower and/or Guarantor under the Credit Agreements. As at March 31, 2012 there was approximately $252 million of aggregate principal amount outstanding under the First Lien Credit Agreement (plus approximately $12 million in letter of credit exposure) and approximately $12 million of aggregate principal amount outstanding under the Second Lien Credit Agreement. The total claims against the Applicants far exceed $5 million.

Bell Affidavit, paras. 75; Application Record, Tab 2.

B. The Relief is Available under The CCAA and Consistent with the Purpose and Policy of the CCAA

(1) The CCAA is Flexible, Remedial Legislation

58. The CCAA is remedial legislation, intended to facilitate compromises and arrangements between companies and their creditors as an alternative to bankruptcy. In particular during periods of financial hardship, debtors turn to the Court so that the Court may apply the CCAA in a flexible manner in order to accomplish the statute's goals. The Court should give the CCAA a broad and liberal interpretation so as to encourage and facilitate successful restructurings whenever possible.

Nova Metal Products Inc. v. Comiskey (Trustee of), *supra* at paras. 22 and 56-60; Book of Authorities, Tab 4. *Lehndorff General Partner Ltd., Re* (1993), 17 C.B.R. (3d) 24 (Ont. Gen. Div. [Commercial List]) at para. 5; Book of Authorities, Tab 6.

Hongkong Bank of Canada v. Chef Ready Foods Ltd. (1990), 4 C.B.R. (3d) 311 (B.C. C.A.), at pp. 4 and 7; Book of Authorities, Tab 7.

59. On numerous occasions, courts have held that Section 11 of the CCAA provides the courts with a broad and liberal power, which is at their disposal in order to achieve the overall objective of the CCAA. Accordingly, an interpretation of the CCAA that facilitates restructurings accords with its purpose.

Sulphur Corp. of Canada Ltd., Re (2002), 35 C.B.R. (4th) 304 (Alta. Q.B.) ("*Sulphur*") at para. 26; Book of Authorities, Tab 8.

60. Given the nature and purpose of the CCAA, this Honourable Court has the authority and jurisdiction to depart from the Model Order as is reasonable and necessary in order to achieve a successful restructuring.

(2) The Stay of Proceedings Against Non-Applicants is Appropriate

61. The relief sought in this application includes a stay of proceedings in favour of Cinram LP and the Applicants' direct and indirect subsidiaries that are also party to an agreement with an Applicant (whether as surety, guarantor or otherwise) (each, a "Subsidiary Counterparty"), including any contract or credit agreement. It is just and reasonable to grant the requested stay of proceedings because:

a. the Cinram Business is integrated among the Applicants, Cinram LP and the Subsidiary Counterparties;

b. if any proceedings were commenced against Cinram LP, or if any of the third parties to such agreements were to commence proceedings or exercise rights and remedies against the Subsidiary Counterparties, this would have a detrimental effect on the Applicants' ability to restructure and implement the Proposed Transaction and would lead to an erosion of value of the Cinram Business; and

c. a stay of proceedings that extends to Cinram LP and the Subsidiary Counterparties is necessary in order to maintain stability with respect to the Cinram Business and maintain value for the benefit of the Applicants' stakeholders.

Bell Affidavit, paras. 185-186; Application Record, Tab 2.

62. The purpose of the CCAA is to preserve the *status quo* to enable a plan of compromise to be prepared, filed and considered by the creditors:

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.

Lehndorff General Partner Ltd., Re, *supra* at para. 5; Book of Authorities, Tab 6. *Canwest Global Communications Corp., Re*, *supra* at para. 27; Book of Authorities, Tab 1.

CCAA, Section 11.

63. The Court has broad inherent jurisdiction to impose stays of proceedings that supplement the statutory provisions of Section 11 of the CCAA, providing the Court with the power to grant a stay of proceedings where it is just and reasonable to do so, including with respect to non-applicant parties.

Lehndorff General Partner Ltd., Re, *supra* at paras. 5 and 16; Book of Authorities, Tab 6.

T. Eaton Co., Re (1997), 46 C.B.R. (3d) 293 (Ont. Gen. Div.) at para. 6; Book of Authorities, Tab 9.

64. The Courts have found it just and reasonable to grant a stay of proceedings against third party non-applicants in a number of circumstances, including:

a. where it is important to the reorganization process;

b. where the business operations of the Applicants and the third party non-applicants are intertwined and the third parties are not subject to the jurisdiction of the CCAA, such as partnerships that do not qualify as "companies" within the meaning of the CCAA;

c. against non-applicant subsidiaries of a debtor company where such subsidiaries were guarantors under the note indentures issued by the debtor company; and

d. against non-applicant subsidiaries relating to any guarantee, contribution or indemnity obligation, liability or claim in respect of obligations and claims against the debtor companies.

Woodward's Ltd., Re (1993), 17 C.B.R. (3d) 236 (B.C. S.C.) at para. 31; Book of Authorities, Tab 10. *Lehndorff General Partner Ltd., Re*, *supra* at para. 21; Book of Authorities, Tab 6.

Canwest Global Communications Corp., Re, *supra* at paras. 28 and 29; Book of Authorities, Tab 1.

Sino-Forest Corp., Re, 2012 ONSC 2063 (Ont. S.C.J. [Commercial List]) at paras. 5, 18, and 31; Book of Authorities, Tab 11.

Re MAAX Corp, Initial Order granted June 12, 2008, Montreal 500-11-033561-081, (Que. Sup. Ct. [Commercial Division]) at para. 7; Book of Authorities, Tab 12.

65. The Applicants submit the balance of convenience favours extending the relief in the proposed Initial Order to Cinram LP and the Subsidiary Counterparties. The business operations of the Applicants, Cinram LP and the Subsidiary Counterparties are intertwined and the stay of proceedings is necessary to maintain stability and value for the benefit of the Applicants' stakeholders, as well as allow an orderly, going-concern sale of the Cinram Business as an important component of its reorganization process.

(3) Entitlement to Make Pre-Filing Payments

66. To ensure the continued operation of the CCAA Parties' business and maximization of value in the interests of Cinram's stakeholders, the Applicants seek authorization (but not a requirement) for the CCAA Parties to make certain pre-filing payments, including: (a) payments to employees in respect of wages, benefits, and related amounts; (b) payments to suppliers and service providers critical to the ongoing operation of the business; (c) payments and the application of credits in connection with certain existing customer programs; and (d) intercompany payments among the Applicants related to intercompany loans and shared services. Payments will be made with the consent of the Monitor and, in certain circumstances, with the consent of the Agent.

67. There is ample authority supporting the Court's general jurisdiction to permit payment of pre-filing obligations to persons whose services are critical to the ongoing operations of the debtor companies. This jurisdiction of the Court is not ousted by Section 11.4 of the CCAA, which became effective as part of the 2009 amendments to the CCAA and codified the Court's practice of declaring a person to be a critical supplier and granting a charge on the debtor's property in favour of such critical supplier. As noted by Pepall J. in *Canwest Global Communications Corp., Re*, the recent amendments,

including Section 11.4, do not detract from the inherently flexible nature of the CCAA or the Court's broad and inherent jurisdiction to make such orders that will facilitate the debtor's restructuring of its business as a going concern.

Canwest Global Communications Corp., Re supra, at paras. 41 and 43; Book of Authorities, Tab 1.

68. There are many cases since the 2009 amendments where the Courts have authorized the applicants to pay certain pre-filing amounts where the applicants were not seeking a charge in respect of critical suppliers. In granting this authority, the Courts considered a number of factors, including:

a. whether the goods and services were integral to the business of the applicants;

b. the applicants' dependency on the uninterrupted supply of the goods or services;

c. the fact that no payments would be made without the consent of the Monitor;

d. the Monitor's support and willingness to work with the applicants to ensure that payments to suppliers in respect of pre-filing liabilities are minimized;

e. whether the applicants had sufficient inventory of the goods on hand to meet their needs; and

f. the effect on the debtors' ongoing operations and ability to restructure if they were unable to make pre-filing payments to their critical suppliers.

Canwest Global Communications Corp., Re supra, at para. 43; Book of Authorities, Tab 1.

Brainhunter Inc., Re, [2009] O.J. No. 5207 (Ont. S.C.J. [Commercial List]) at para. 21 [*Brainhunter*]; Book of Authorities, Tab 13.

Priszm Income Fund, Re (2011), 75 C.B.R. (5th) 213 (Ont. S.C.J.) at paras. 29-34; Book of Authorities, Tab 14.

69. The CCAA Parties rely on the efficient and expedited supply of products and services from their suppliers and service providers in order to ensure that their operations continue in an efficient manner so that they can satisfy customer requirements. The CCAA Parties operate in a highly competitive environment where the timely provision of their products and services is essential in order for the company to remain a successful player in the industry and to ensure the continuance of the Cinram Business. The CCAA Parties require flexibility to ensure adequate and timely supply of required products and to attempt to obtain and negotiate credit terms with its suppliers and service providers. In order to accomplish this, the CCAA Parties require the ability to pay certain pre-filing amounts and post-filing payables to those suppliers they consider essential to the Cinram Business, as approved by the Monitor. The Monitor, in determining whether to approve pre-filing payments as critical to the ongoing business operations, will consider various factors, including the above factors derived from the caselaw.

Bell Affidavit, paras. 226, 228, 230; Application Record, Tab 2.

70. In addition, the CCAA Parties' continued compliance with their existing customer programs, as described in the Bell Affidavit, including the payment of certain pre-filing amounts owing under certain customer programs and the application of certain credits granted to customers pre-filing to post-filing receivables, is essential in order for the CCAA Parties to maintain their customer relationships as part of the CCAA Parties' going concern business.

Bell Affidavit, paras. 234; Application Record, Tab 2.

71. Further, due to the operational integration of the businesses of the CCAA Parties, as described above, there is a significant volume of financial transactions between and among the Applicants, including, among others, charges by an Applicant providing shared services to another Applicant of intercompany accounts due from the recipients of those

services, and charges by a Applicant that manufactures and furnishes products to another Applicant of inter-company accounts due from the receiving entity.

Bell Affidavit, paras. 225; Application Record, Tab 2.

72. Accordingly, the Applicants submit that it is appropriate in the present circumstances for this Honourable Court to exercise its jurisdiction and grant the CCAA Parties the authority to make the pre-filing payments described in the proposed Initial Order subject to the terms therein.

(4) The Charges Are Appropriate

73. The Applicants seek approval of certain Court-ordered charges over their assets relating to their DIP Financing (defined below), administrative costs, indemnification of their trustees, directors and officers, KERP and Support Agreement. The Lenders and the Administrative Agent under the Credit Agreements, the senior secured facilities that will be primed by the charges, have been provided with notice of the within Application. The proposed Initial Order does not purport to give the Court-ordered charges priority over any other validly perfected security interests.

(A) DIP Lenders' Charge

74. In the proposed Initial Order, the Applicants seek approval of the DIP Credit Agreement providing a debtor-in-possession term facility in the principal amount of $15 million (the "DIP Financing"), to be secured by a charge over all of the assets and property of the Applicants that are Borrowers and/or Guarantors under the Credit Agreements (the "Charged Property") ranking ahead of all other charges except the Administration Charge.

75. Section 11.2 of the CCAA expressly provides the Court the statutory jurisdiction to grant a debtor-in-possession ("DIP") financing charge:

> 11.2(1) *Interim financing* - On application by a debtor company and on notice to the secured creditors who are likely to be affected by the security or charge, a court may make an order declaring that all or part of the company's property is subject to a security or charge — in an amount that the court considers appropriate — in favour of a person specified in the order who agrees to lend to the company an amount approved by the court as being required by the company, having regard to its cash-flow statement. The security or charge may not secure an obligation that exists before the order is made.
>
> 11.2(2) *Priority* — secured creditors — The court may order that the security or charge rank in priority over the claim of any secured creditor of the company.
>
> *Timminco Ltd., Re*, 211 A.C.W.S. (3d) 881 (Ont. S.C.J. [Commercial List]) [2012 CarswellOnt 1466] at para. 31; Book of Authorities, Tab 15. CCAA, Section 11.2(1) and (2).

76. Section 11.2 of the CCAA sets out the following factors to be considered by the Court in deciding whether to grant a DIP financing charge:

> 11.2(4) Factors to be considered — In deciding whether to make an order, the court is to consider, among other things,
>
> (a) the period during which the company is expected to be subject to proceedings under this Act;
>
> (b) how the company's business and financial affairs are to be managed during the proceedings;
>
> (c) whether the company's management has the confidence of its major creditors;
>
> (d) whether the loan would enhance the prospects of a viable compromise or arrangement being made in respect of the company;

(e) the nature and value of the company's property;

(f) whether any creditor would be materially prejudiced as a result of the security or charge; and

(g) the monitor's report referred to in paragraph 23(1)(*b*), if any.

CCAA, Section 11.2(4).

77. The above list of factors is not exhaustive, and it may be appropriate for the Court to consider additional factors in determining whether to grant a DIP financing charge. For example, in circumstances where funds to be borrowed pursuant to a DIP facility were not expected to be immediately necessary, but applicants' cash flow statements projected the need for additional liquidity, the Court in granting the requested DIP charge considered the fact that the applicants' ability to borrows funds that would be secured by a charge would help retain the confidence of their trade creditors, employees and suppliers.

Canwest Publishing Inc./Publications Canwest Inc., Re (2010), 63 C.B.R. (5th) 115 (Ont. S.C.J. [Commercial List]) at paras. 42-43 [*Canwest Publishing*]; Book of Authorities, Tab 16.

78. Courts in recent cross-border cases have exercised their broad power to grant charges to DIP lenders over the assets of foreign applicants. In many of these cases, the debtors have commenced recognition proceedings under Chapter 15.

Re Catalyst Paper Corporation, Initial Order granted on January 31, 2012, Court File No. S-120712 (B.C.S.C.) [*Catalyst Paper*]; Book of Authorities, Tab 17.

Angiotech, supra, Initial Order granted on January 28, 2011, Court File No. S-110587; Book of Authorities, Tab 18

Fraser Papers Inc., Re [2009 CarswellOnt 3658 (Ont. S.C.J. [Commercial List])], Initial Order granted on June 18, 2009, Court File No. CV-09-8241-00CL; Book of Authorities, Tab 19.

79. As noted above, pursuant to Section 11.2(1) of the CCAA, a DIP financing charge may not secure an obligation that existed before the order was made. The requested DIP Lenders' Charge will not secure any pre-filing obligations.

80. The following factors support the granting of the DIP Lenders' Charge, many of which incorporate the considerations enumerated in Section 11.2(4) listed above:

a. the Cash Flow Forecast indicates the Applicants will need additional liquidity afforded by the DIP Financing in order to continue operations through the duration of these proposed CCAA Proceedings;

b. the Cinram Business is intended to continue to operate on a going concern basis during these CCAA Proceedings under the direction of the current management with the assistance of the Applicants' advisors and the Monitor;

c. the DIP Financing is expected to provide the Applicants with sufficient liquidity to implement the Proposed Transaction through these CCAA Proceedingsand implement certain operational restructuring initiatives, which will materially enhance the likelihood of a going concern outcome for the Cinram Business;

d. the nature and the value of the Applicants' assets as set out in their consolidated financial statements can support the requested DIP Lenders' Charge;

e. members of the Steering Committee under the First Lien Credit Agreement, who are senior secured creditors of the Applicants, have agreed to provide the DIP Financing;

f. the proposed DIP Lenders have indicated that they will not provide the DIP Financing if the DIP Lenders' Charge is not approved;

g. the DIP Lenders' Charge will not secure any pre-filing obligations;

h. the senior secured lenders under the Credit Agreements affected by the charge have been provided with notice of these CCAA Proceedings;and

i. the proposed Monitor is supportive of the DIP Facility, including the DIP Lenders' Charge.

Bell Affidavit, paras. 199-202, 205-208; Application Record, Tab 2.

(B) Administration Charge

81. The Applicants seek a charge over the Charged Property in the amount of CAD$3.5 million to secure the fees of the Monitor and its counsel, the Applicants' Canadian and U.S. counsel, the Applicants' Investment Banker, the Canadian and U.S. Counsel to the DIP Agent, the DIP Lenders, the Administrative Agent and the Lenders under the Credit Agreements, and the financial advisor to the DIP Lenders and the Lenders under the Credit Agreements (the "Administration Charge"). This charge is to rank in priority to all of the other charges set out in the proposed Initial Order.

82. Prior to the 2009 amendments, administration charges were granted pursuant to the inherent jurisdiction of the Court. Section 11.52 of the CCAA now expressly provides the court with the jurisdiction to grant an administration charge:

11.52(1) *Court may order security or charge to cover certain costs*

On notice to the secured creditors who are likely to be affected by the security or charge, the court may make an order declaring that all or part of the property of a debtor company is subject to a security or charge — in an amount that the court considers appropriate — in respect of the fees and expenses of

(a) the monitor, including the fees and expenses of any financial, legal or other experts engaged by the monitor in the performance of the monitor's duties;

(b) any financial, legal or other experts engaged by the company for the purpose of proceedings under this Act; and

(c) any financial, legal or other experts engaged by any other interested person if the court is satisfied that the security or charge is necessary for their effective participation in proceedings under this Act.

11.52(2) *Priority*

The court may order that the security or charge rank in priority over the claim of any secured creditor of the company.

CCAA, Section 11.52(1) and (2).

82. Administration charges were granted pursuant to Section 11.52 in, among other cases, *Timminco Ltd., Re*, *Canwest Global Communications Corp., Re* and *Canwest Publishing Inc./Publications Canwest Inc., Re.*

Canwest Global Communications Corp., Re, *supra*; Book of Authorities, Tab 1.

Canwest Publishing, *supra*; Book of Authorities, Tab 16.

Timminco Ltd., Re, 2012 ONSC 106 (Ont. S.C.J. [Commercial List]) [*Timminco*]; Book of Authorities, Tab 20.

84. In *Canwest Publishing*, the Court noted Section 11.52 does not contain any specific criteria for a court to consider in granting an administration charge and provided a list of non-exhaustive factors to consider in making such an

assessment. These factors were also considered by the Court in *Timminco*. The list of factors to consider in approving an administration charge include:

a. the size and complexity of the business being restructured;

b. the proposed role of the beneficiaries of the charge;

c. whether there is unwarranted duplication of roles;

d. whether the quantum of the proposed charge appears to be fair and reasonable;

e. the position of the secured creditors likely to be affected by the charge; and

f. the position of the Monitor.

Canwest Publishing supra, at para. 54; Book of Authorities, Tab 16.

Timminco, supra, at paras. 26-29; Book of Authorities, Tab 20.

85. The Applicants submit that the Administration Charge is warranted and necessary, and that it is appropriate in the present circumstances for this Honourable Court to exercise its jurisdiction and grant the Administration Charge, given:

a. the proposed restructuring of the Cinram Business is large and complex, spanning several jurisdictions across North America and Europe, and will require the extensive involvement of professional advisors;

b. the professionals that are to be beneficiaries of the Administration Charge have each played a critical role in the CCAA Parties' restructuring efforts to date and will continue to be pivotal to the CCAA Parties' ability to pursue a successful restructuring going forward, including the Investment Banker's involvement in the completion of the Proposed Transaction;

c. there is no unwarranted duplication of roles;

d. the senior secured creditors affected by the charge have been provided with notice of these CCAA Proceedings; and

e. the Monitor is in support of the proposed Administration Charge.

Bell Affidavit, paras. 188, 190; Application Record, Tab 2.

(C) Directors' Charge

86. The Applicants seek a Directors' Charge in an amount of CAD$13 over the Charged Property to secure their respective indemnification obligations for liabilities imposed on the Applicants' trustees, directors and officers (the "Directors and Officers"). The Directors' Charge is to be subordinate to the Administration Charge and the DIP Lenders' Charge but in priority to the KERP Charge and the Consent Consideration Charge.

87. Section 11.51 of the CCAA affords the Court the jurisdiction to grant a charge relating to directors' and officers' indemnification on a priority basis:

11.51(1) *Security or charge relating to director's indemnification*

On application by a debtor company and on notice to the secured creditors who are likely to be affected by the security or charge — in an amount that the court considers appropriate — in favour of any director or officer of the company to indemnify the director or officer against obligations and liabilities that they may incur as a director or officer of the company after the commencement of proceedings under this Act.

11.51(2) *Priority*

The court may order that the security or charge rank in priority over the claim of any secured creditors of the company

11.51(3) *Restriction* — indemnification insurance

The court may not make the order if in its opinion the company could obtain adequate indemnification insurance for the director or officer at a reasonable cost.

11.51(4) *Negligence, misconduct or fault*

The court shall make an order declaring that the security or charge does not apply in respect of a specific obligation or liability incurred by a director or officer if in its opinion the obligation or liability was incurred as a result of the director's or officer's gross negligence or wilful misconduct or, in Quebec, the director's or officer's gross or intentional fault.

CCAA, Section 11.51.

88. The Court has granted director and officer charges pursuant to Section 11.51 in a number of cases. In *Canwest Global Communications Corp., Re*, the Court outlined the test for granting such a charge:

I have already addressed the issue of notice to affected secured creditors. I must also be satisfied with the amount and that the charge is for obligations and liabilities the directors and officers may incur after the commencement of proceedings. It is not to extend to coverage of wilful misconduct or gross negligence and no order should be granted if adequate insurance at a reasonable cost could be obtained.

Canwest Global Communications Corp., Re, *supra* at paras 46-48; Book of Authorities, Tab 1.

Canwest Publishing, *supra* at paras. 56-57; Book of Authorities, Tab 16.

Timminco, *supra* at paras. 30-36; Book of Authorities, Tab 20.

89. The Applicants submit that the D&O Charge is warranted and necessary, and that it is appropriate in the present circumstances for this Honourable Court to exercise its jurisdiction and grant the D&O Charge in the amount of CAD $13 million, given:

a. the Directors and Officers of the Applicants may be subject to potential liabilities in connection with these CCAA proceedings with respect to which the Directors and Officers have expressed their desire for certainty with respect to potential personal liability if they continue in their current capacities;

b. renewal of coverage to protect the Directors and Officers is at a significantly increased cost due to the imminent commencement of these CCAA proceedings;

c. the Directors' Charge would cover obligations and liabilities that the Directors and Officers, as applicable, may incur after the commencement of these CCAA Proceedings and is not intended to cover wilful misconduct or gross negligence;

d. the Applicants require the continued support and involvement of their Directors and Officers who have been instrumental in the restructuring efforts of the CCAA Parties to date;

e. the senior secured creditors affected by the charge have been provided with notice of these CCAA proceedings; and

f. the Monitor is in support of the proposed Directors' Charge.

Bell Affidavit, paras. 249, 250, 254-257; Application Record, Tab 2.

(D) KERP Charge

90. The Applicants seek a KERP Charge in an amount of CAD$3 million over the Charged Property to secure the KERP Retention Payments, KERP Transaction Payments and Aurora KERP Payments payable to certain key employees of the CCAA Parties crucial for the CCAA Parties' successful restructuring.

91. The CCAA is silent with respect to the granting of KERP charges. Approval of a KERP and a KERP charge are matters within the discretion of the Court. The Court in *Grant Forest Products Inc., Re* [2009 CarswellOnt 4699 (Ont. S.C.J. [Commercial List])] considered a number of factors in determining whether to grant a KERP and a KERP charge, including:

a. whether the Monitor supports the KERP agreement and charge (to which great weight was attributed);

b. whether the employees to which the KERP applies would consider other employment options if the KERP agreement were not secured by the KERP charge;

c. whether the continued employment of the employees to which the KERP applies is important for the stability of the business and to enhance the effectiveness of the marketing process;

d. the employees' history with and knowledge of the debtor;

e. the difficulty in finding a replacement to fulfill the responsibilities of the employees to which the KERP applies;

f. whether the KERP agreement and charge were approved by the board of directors, including the independent directors, as the business judgment of the board should not be ignored;

g. whether the KERP agreement and charge are supported or consented to by secured creditors of the debtor; and

h. whether the payments under the KERP are payable upon the completion of the restructuring process.

Grant Forest Products Inc., Re, 57 C.B.R. (5th) 128 (Ont. S.C.J. [Commercial List]) at para. 8-24 [*Grant Forest*]; Book of Authorities, Tab 21.

Canwest Publishing Inc./Publications Canwest Inc., Re supra, at paras 59; Book of Authorities, Tab 16.

Canwest Global Communications Corp., Re supra, at para. 49; Book of Authorities, Tab 1.

Timminco Ltd., Re (2012), 95 C.C.P.B. 48 (Ont. S.C.J. [Commercial List]) at paras. 72-75; Book of Authorities, Tab 22.

92. The purpose of a KERP arrangement is to retain key personnel for the duration of the debtor's restructuring process and it is logical for compensation under a KERP arrangement to be deferred until after the restructuring process has been completed, with "staged bonuses" being acceptable. KERP arrangements that do not defer retention payments to completion of the restructuring may also be just and fair in the circumstances.

Grant Forest Products Inc., Re, supra at para. 22-23; Book of Authorities, Tab 21.

93. The Applicants submit that the KERP Charge is warranted and necessary, and that it is appropriate in the present circumstances for this Honourable Court to exercise its jurisdiction and grant the KERP Charge in the amount of CAD $3 million, given:

a. the KERP was developed by Cinram with the principal purpose of providing an incentive to the Eligible Employees, the Eligible Officers, and the Aurora Employees to remain with the Cinram Group while the company pursued its restructuring efforts;

b. the Eligible Employees and the Eligible Officers are essential for a restructuring of the Cinram Group and the preservation of Cinram's value during the restructuring process;

c. the Aurora Employees are essential for an orderly transition of Cinram Distribution's business operations from the Aurora facility to its Nashville facility;

d. it would be detrimental to the restructuring process if Cinram were required to find replacements for the Eligible Employees, the Eligible Officers and/or the Aurora Employees during this critical period;

e. the KERP, including the KERP Retention Payments, the KERP Transaction Payments and the Aurora KERP Payments payable thereunder, not only provides appropriate incentives for the Eligible Employees, the Eligible Officers and the Aurora Employees to remain in their current positions, but also ensures that they are properly compensated for their assistance in Cinram's restructuring process;

f. the senior secured creditors affected by the charge have been provided with notice of these CCAA proceedings; and

g. the KERP has been reviewed and approved by the board of trustees of Cinram Fund and is supported by the Monitor.

Bell Affidavit, paras. 236-239, 245-247; Application Record, Tab 2.

(E) Consent Consideration Charge

94. The Applicants request the Consent Consideration Charge over the Charged Property to secure the Early Consent Consideration. The Consent Consideration Charge is to be subordinate in priority to the Administration Charge, the DIP Lenders' Charge, the Directors' Charge and the KERP Charge.

95. The Courts have permitted the opportunity to receive consideration for early consent to a restructuring transaction in the context of CCAA proceedings payable upon implementation of such restructuring transaction. In *Sino-Forest Corp., Re*, the Court ordered that any noteholder wishing to become a consenting noteholder under the support agreement and entitled to early consent consideration was required to execute a joinder agreement to the support agreement prior to the applicable consent deadline. Similarly, in these proceedings, lenders under the First Lien Credit Agreement who execute the Support Agreement (or a joinder thereto) and thereby agree to support the Proposed Transaction on or before July 10, 2012, are entitled to Early Consent Consideration earned on consummation of the Proposed Transaction to be paid from the net sale proceeds.

Sino-Forest Corp., Re, *supra*, Initial Order granted on March 30, 2012, Court File No. CV-12-9667-00CL at para. 15; Book of Authorities, Tab 23. Bell Affidavit, para. 176; Application Record, Tab 2.

96. The Applicants submit it is appropriate in the present circumstances for this Honourable Court to exercise its jurisdiction and grant the Consent Consideration Charge, given:

a. the Proposed Transaction will enable the Cinram Business to continue as a going concern and return to a market leader in the industry;

b. Consenting Lenders are only entitled to the Early Consent Consideration if the Proposed Transaction is consummated; and

c. the Early Consent Consideration is to be paid from the net sale proceeds upon distribution of same in these proceedings.

Bell Affidavit, para. 176; Application Record, Tab 2.

Application granted.

TAB 6

2009 ONCA 421
Ontario Court of Appeal

Garfin v. Mirkopoulos

2009 CarswellOnt 2818, 2009 ONCA 421, 177 A.C.W.S. (3d) 896, 250 O.A.C. 168, 71 C.P.C. (6th) 210

Susan W. Garfin (Applicant / Appellant) and Nikolaos Mirkopoulos and Julie Crossen (Respondents)

D. Doherty, S.T. Goudge, R.J. Sharpe JJ.A.

Heard: April 23, 2009
Judgment: May 22, 2009 *
Docket: CA C49343

Proceedings: reversing in part *Garfin v. Mirkopoulos* (2008), 2008 CarswellOnt 4906 (Ont. S.C.J.); additional reasons at *Garfin v. Mirkopoulos* (2008), 2008 CarswellOnt 7525 (Ont. S.C.J.)

Counsel: Alan J. Lenczner, Q.C. for Appellant
Ronald Birken for Respondent, Nikolaos Mirkopoulos

Subject: Public; Torts; Civil Practice and Procedure

Headnote

Professions and occupations --- Barristers and solicitors — Fees — Agreements for fees — Existence of agreement

Lawyer represented wife in contested matrimonial proceeding — Wife terminated retainer and reached settlement agreement without any input from lawyer — Settlement agreement provided that parties would each be responsible for their own legal costs — Lawyer brought action against husband and wife to recover unpaid fees on grounds that they colluded to prevent her from recovering fees — Trial judge dismissed collusion claim but held that husband was liable for lawyer's account in contract on basis that husband promised wife he would pay it — Trial judge found that fees claimed were excessive and reduced lawyer's account — Lawyer appealed reduction in bill against husband — Husband cross-appealed finding that he was liable for lawyer's account — Appeal dismissed and cross-appeal allowed — Issue arose as to whether husband was liable to lawyer in contract — Evidence was not capable of supporting trial judge's finding of agreement by husband to pay lawyer's account and as lawyer did not plead claim in contract, issue was not properly addressed at trial — Trial judge did not explain evidence that she relied upon to find that husband agreed with wife to pay lawyer's account — Settlement agreement was clear that each party was to pay own costs — Trial judge erred in awarding judgment against husband on ground that was not pleaded or litigated at trial — Agreement upon which trial judge based her finding of liability was not pleaded and that parties did not join issue on any such alleged agreement at trial.

Civil practice and procedure --- Pleadings — General requirements — Departure from pleadings

Lawyer represented wife in contested matrimonial proceeding — Wife terminated retainer and reached settlement agreement without any input from lawyer — Settlement agreement provided that parties would each be responsible for their own legal costs — Lawyer brought action against husband and wife to recover unpaid fees on grounds that they colluded to prevent her from recovering fees — Trial judge dismissed collusion claim but held that husband was liable for lawyer's account in contract on basis that husband promised wife he would pay it — Trial judge found that fees claimed were excessive and reduced lawyer's account — Lawyer appealed reduction in bill against husband — Husband cross-appealed finding that he was liable for lawyer's account — Appeal dismissed and cross-

appeal allowed — Issue arose as to whether husband was liable to lawyer in contract — Evidence was not capable of supporting trial judge's finding of agreement by husband to pay lawyer's account and as lawyer did not plead claim in contract, issue was not properly addressed at trial — Trial judge did not explain evidence that she relied upon to find that husband agreed with wife to pay lawyer's account — Settlement agreement was clear that each party was to pay own costs — Trial judge erred in awarding judgment against husband on ground that was not pleaded or litigated at trial — Agreement upon which trial judge based her finding of liability was not pleaded and that parties did not join issue on any such alleged agreement at trial.

Professions and occupations --- Barristers and solicitors — Fees — Accounting and refunding by solicitor — Application for assessment, review, or taxation of account — Considerations on review of account — Miscellaneous

Collusion.

Table of Authorities

Cases considered by *R.J. Sharpe J.A.*:

Dicarllo v. McLean (1915), 33 O.L.R. 231 (Ont. C.A.) — considered

Dyck v. Manitoba Snowmobile Assn. Inc. (1982), 1982 CarswellMan 93, 21 C.C.L.T. 38, [1982] 4 W.W.R. 318, 136 D.L.R. (3d) 11, 15 Man. R. (2d) 404 (Man. C.A.) — referred to

Fraser River Pile & Dredge Ltd. v. Can-Dive Services Ltd. (1999), 127 B.C.A.C. 287, 207 W.A.C. 287, 67 B.C.L.R. (3d) 213, 47 C.C.L.T. (2d) 1, 1999 A.M.C. 2840, 50 B.L.R. (2d) 169, [1999] 3 S.C.R. 108, [2000] 1 Lloyd's Rep. 199, 176 D.L.R. (4th) 257, 245 N.R. 88, 1999 CarswellBC 1927, 1999 CarswellBC 1928, [1999] I.L.R. I-3717, [1999] 9 W.W.R. 380, 11 C.C.L.I. (3d) 1 (S.C.C.) — considered

Gardiner Miller Arnold LLP v. Kymbo International Inc. (2007), 2007 ONCA 648, 2007 CarswellOnt 5933, 45 C.P.C. (6th) 202, 33 B.L.R. (4th) 34 (Ont. C.A.) — considered

London Drugs Ltd. v. Kuehne & Nagel International Ltd. (1992), [1993] 1 W.W.R. 1, [1992] 3 S.C.R. 299, *(*sub nom. *London Drugs Ltd. v. Brassart)* 143 N.R. 1, 73 B.C.L.R. (2d) 1, 43 C.C.E.L. 1, 13 C.C.L.T. (2d) 1, *(*sub nom. *London Drugs Ltd. v. Brassart)* 18 B.C.A.C. 1, *(*sub nom. *London Drugs Ltd. v. Brassart)* 31 W.A.C. 1, 97 D.L.R. (4th) 261, 1992 CarswellBC 913, 1992 CarswellBC 315 (S.C.C.) — considered

Miida Electronics Inc. v. Mitsui O.S.K. Lines Ltd. (1986), 1986 A.M.C. 2580, *(*sub nom. *ITO - International Terminal Operators Ltd. v. Miida Electronics Inc.)* [1986] 1 S.C.R. 752, 28 D.L.R. (4th) 641, 68 N.R. 241, 34 B.L.R. 251, 1986 CarswellNat 14, 1986 CarswellNat 736 (S.C.C.) — referred to

Price v. Crouch (1891), 60 L.J.Q.B. 767 (Eng. Q.B.) — considered

TSP-Intl Ltd. v. Mills (2006), 19 B.L.R. (4th) 21, 2006 CarswellOnt 4037, 212 O.A.C. 66, 81 O.R. (3d) 266 (Ont. C.A.) — considered

APPEAL by lawyer and CROSS-APPEAL by opposing party from judgment reported at *Garfin v. Mirkopoulos* (2008), 2008 CarswellOnt 4906 (Ont. S.C.J.), relating to payment of solicitor's fees.

***R.J. Sharpe J.A.*:**

1 This appeal involves a claim by the lawyer for one party in a matrimonial litigation to recover her fees and disbursements from both her client and the opposite party. The appellant represented the respondent Julie Crossen in a hotly contested matrimonial proceeding against the other respondent, Nikolaos Mirkopoulos. The appellant claimed the sum of $217,773.24 for unpaid fees and disbursements. Crossen terminated the appellant's retainer and reached a settlement agreement with Mirkopoulos without any input from the appellant. That settlement agreement provided that the parties would each be responsible for their own legal costs. The appellant brought this action to recover the amount of her account from both Crossen and Mirkopoulos, alleging that the two had colluded with each other to prevent Garfin from recovering her fees.

2 The trial judge dismissed the collusion claim but held that Mirkopoulos was liable for the appellant's account in contract on the basis that Mirkopoulos had promised Crossen that he would pay it. The trial judge also found, however, that the fees claimed were excessive and reduced the appellant's account to $50,000.

3 The appellant seeks no relief in this court against Crossen but appeals the reduction of the bill as against Mirkopoulos. Mirkopoulos cross-appeals the finding that he is liable for the appellant's account in contract. The appellant submits that if the contract finding is set aside, she is entitled to recover on the basis of collusion.

Facts

4 Crossen met Mirkopoulos, a man of considerable financial means, in 1998 when she was 25 and he was 57. The trial judge found that they began to live together in April 2001 and that they were married in July 2001. Crossen complained that Mirkopoulos assaulted her, and they separated in August 2002. Lengthy and acrimonious matrimonial litigation ensued. The appellant represented Crossen in that litigation for more than four years. Crossen suffered health problems and was a difficult client. There were many pretrial motions and case conferences on issues of disclosure and interim support.

5 The appellant secured a favorable interim support order for Crossen of $4,000 per month. The matter was set down for trial, scheduled to begin in May 2007. In February 2007, Crossen suggested to Mirkopoulos that they meet with a view to settling the litigation. At the time, Crossen's support order was being garnished for outstanding costs orders in favour of Mirkopoulos' two brothers, who had been parties in related proceedings, and she was unable to get in touch with the appellant in order to deal with this matter. Crossen testified that Mirkopoulos encouraged her to terminate the appellant's retainer. Mirkopoulos denied that he had done so. In any event, Crossen did terminate the appellant's retainer in early March 2007. Following an unsuccessful mediation, Crossen and Mirkopoulos attended a trial management conference on March 30, 2007 and executed a separation agreement settling the litigation. Crossen was unrepresented at the time, while Mirkopoulos was advised by counsel who drafted the agreement. The agreement provided for a final, one time support payment to Crossen of $33,000 and provided that the parties would each be responsible for their own legal fees.

6 At the time of the termination of the retainer, the appellant's unpaid account was for $217,773.24. The appellant had already received approximately $58,000 for legal fees during the course of the litigation from interim payments made by Mirkopoulos to Crossen.

Issues

7 I will consider the issues raised in both the appeal and cross-appeal in the following order:

1. Did the trial judge err by finding Mirkopoulos liable to the appellant in contract?

2. Did the trial judge err by rejecting the claim against Mirkopoulos based on collusion?

3. Did the trial judge err by reducing the appellant's account to $50,000?

Analyis

1. Did the trial judge err by finding Mirkopoulos liable to the appellant in contract?

8 The trial judge found that "it was always Mr. Mirkopoulos' intention that he would pay Ms. Garfin's account after it was assessed" (para. 57) and that "Mr. Mirkopoulos always took the position that he would contribute to Ms. Garfin's legal fees after they were assessed" (para. 62). The trial judge did not explain the evidence she relied upon to find that Mirkopoulos had agreed with Crossen that he would pay the appellant's account.

9 For the following reasons, I conclude that the evidence is simply not capable of supporting the trial judge's finding of an agreement by Mirkopoulos to pay the appellant's account, and further that as the appellant did not plead a claim in contract, the issue was not properly addressed at the trial.

10 I turn first to the evidence relied upon by the appellant to support the trial judge's finding.

11 We were referred to Crossen's examination for discovery where she stated that she was "under the understanding that [Mirkopoulos], after looking after the bills with [his counsel], was going to be taking care of [the appellant's] bills, after it was assessed." Crossen further stated: "we made an agreement that he would take care of [the appellant], and it wasn't to come out of my lousy $32,000". The appellant cross-examined Crossen on her discovery transcript at great length but did not put these passages to her. However, in an attempt to bring the lengthy cross-examination to an end, Mirkopoulos' counsel agreed that the appellant could simply file the transcript as an exhibit.

12 The only trial evidence cited by the appellant to support the finding are portions of Crossen's cross-examination at trial where she testified that Mirkopoulos "never said he would not pay" the appellant's account. Crossen also testified that she was concerned about how the account would be paid and that she did not want to leave the appellant out in the cold. She believed that Mirkopoulos would pay the account after it was assessed:

> ...and all I believe Mr. Mirkopoulos wanted was to be able to assess the bill properly and maybe make some type of settlement to her that wasn't so outrageous because, you know, it would benefit everybody to just get on with their lives if we could do that, and it just didn't seem to ever go for some reason.

13 In my view, the evidence relied on by the appellant, taken at its highest, shows that Crossen hoped or perhaps assumed that Mirkopoulos would pay the account once it was assessed. The fact that Markopoulos indicated during the various settlement discussions that the account would have to be assessed does not amount to an agreement by him to pay the account.

14 There is nothing in Mirkopoulos' own evidence that would support a finding that he agreed to pay the appellant's account. Indeed, the appellant never put the allegation of an agreement to pay the account to him in cross-examination. When asked if Crossen mentioned anything about legal fees at the time the settlement agreement was concluded, Mirkopoulos testified that Crossen had mentioned that she had received a large bill despite that fact that the appellant had been deducting fees every month from her support payments. Mirkopoulos testified that he told Crossen: "Julie, I don't want to know. I got enough in my head." When asked if Crossen made any effort to persuade him to pay the account, he testified that he told her that he saw no consistency in the three or four accounts and that it was his opinion that the appellant had been totally paid by the money she had deducted from Crossen's support payments.

15 There was unequivocal evidence from the mediator, found by the trial judge to be a reliable witness, that Mirkopoulos flatly rejected the suggestion that he pay or contribute to the appellants account as part of the settlement. Finally, the settlement agreement could not be clearer: it specifically provides that the parties will be responsible for their own costs. This evidence, which the trial judge did not consider in her reasons, completely undermines her findings that "it was always Mr. Mirkopoulos' intention that he would pay Ms. Garfin's account after it was assessed" and that "Mr. Mirkopoulos always took the position that he would contribute to Ms. Garfin's legal fees after they were assessed."

16 No doubt an important reason for the lack of evidence on the agreement is that the issue was not pleaded or argued. The statement of claim advances the following claims against Mirkopoulos:

- Mirkopoulos intentionally interfered with the contractual relationship that existed between Crossen and Garfin (para. 2(a))
- Mirkopoulos colluded with Crossen to deprive Garfin of her fees (para. 16)
- Mirkopoulos and Crossen are jointly and severally liable for breach of contract, fraud and conspiracy (para. 18).

17 While the claim states in a conclusory manner that Mirkopoulos is liable for breach of contract, it does not plead facts that are capable of explaining how or why Mirkopoulos is liable for any contractual breach and there is certainly no allegation of an agreement to pay the account made in the statement of claim.

18 The appellant argues that since Mirkopoulos admitted that he knew about the outstanding legal fees and Crossen's financial status, the only probable defence to the collusion claim was that Mirkopoulos had agreed to pay Garfin's fees. Accordingly, it was necessary for Mirkopoulos to adduce evidence on this issue in any event, and so the failure of the statement of claim to plead the contract does not result in any trial unfairness. The appellant's submission on this point rests upon the untenable proposition that Mirkopoulos defeated the collusion claim by establishing that he agreed to pay the appellant's account. That is simply not what happened at this trial. Mirkopoulos did not defeat the collusion claim by advancing an agreement. As I have already noted, the subject of an agreement simply did not come up when he gave his evidence.

19 Because the appellant did not plead that Mirkopoulos agreed with Crossen that he would pay the appellant's legal fees, Mirkopoulos could not be expected to know that he should be prepared to meet that allegation. The trial judge erred in awarding judgment against him on a ground not pleaded and not litigated at trial.

20 It has been repeatedly held was held that it is inappropriate for a case to be decided on an issue not identified by the parties in the pleadings and dealt with at trial: see e.g. *TSP-Intl Ltd. v. Mills* (2006), 81 O.R. (3d) 266 (Ont. C.A.), at para. 35:

> The difficulty here is that the parties did not frame their lawsuit or conduct the trial on these bases. In the context of the case, the defendants were effectively deprived of knowing the case they had to meet, and of any opportunity to meet that case throughout the trial.

21 I conclude, accordingly, that the agreement upon which the trial judge based her finding of liability against Mirkopoulos was not pleaded and that the parties simply did not join issue on any such alleged agreement at trial. In any event, the evidence does not support the trial judge's finding. Accordingly, I would allow also the cross-appeal and dismiss the claim against Mirkopoulos.

22 While that is sufficient to dispose of this aspect the cross-appeal, I would add that even if we were to uphold the finding that Mirkopoulos agreed with Crossen to pay the appellant's account, I fail to see how in law such an agreement would make Mirkopoulos liable to the appellant. The appellant's contractual rights were against her client Crossen. An agreement between Crossen and Mirkopoulos would allow Crossen to claim over against Mirkopoulos if and when sued by the appellant, but would not permit the appellant to sue Mirkopoulos directly.

23 The only argument advanced in support of the contention that the appellant could sue on the agreement was that Crossen was acting as the appellant's agent when she made the alleged contract with Mirkopoulos. I would reject that argument. It was not advanced at trial and there is simply no evidence to support it. In particular, there is nothing in the record to show that the purported agreement was made for the appellant's benefit; that Crossen was acting as Garfin's agent or that she had any authority to do so: see *Dyck v. Manitoba Snowmobile Assn. Inc.* (1982), 136 D.L.R. (3d) 11

(Man. C.A.), at p. 25, aff'd [1985] 1 S.C.R. 589 (S.C.C.); *Miida Electronics Inc. v. Mitsui O.S.K. Lines Ltd.*, [1986] 1 S.C.R. 752 (S.C.C.), at p. 784

24 In *London Drugs Ltd. v. Kuehne & Nagel International Ltd.*, [1992] 3 S.C.R. 299 (S.C.C.), at p. 446, the Supreme Court of Canada held that the "doctrine of privity should not stand in the way of commercial reality and justice". In *Fraser River Pile & Dredge Ltd. v. Can-Dive Services Ltd.*, [1999] 3 S.C.R. 108 (S.C.C.), Iacobucci J. indicated that the third party beneficiary rule might be relaxed where the parties to the contract intend to extend the benefit in question to the third party seeking to rely on the contractual provision and the activities performed by the third party relying on the contract are the very activities contemplated by the contract and the parties.

25 In the present case, denying the appellant the right to sue on the purported contract between Crossen and Mirkopoulos would stand in the way of neither commercial reality nor justice. There is nothing to indicate that the purported agreement was intended to confer rights on the appellant as against Mirkopoulos, or that Mirkopoulos agreed or intended to enter into any kind of arrangement for the benefit of the appellant. The appellant certainly could not have relied on the purported agreement, as it was only entered into after her services had been performed and her fees had been incurred. She provided legal services to Crossen with full knowledge of Crossen's financial circumstances. While the appellant no doubt hoped to secure a judgment or settlement in Crossen's favour that would have required Mirkopoulos to indemnify Crossen for all or part of her legal costs, the appellant could not have had any expectation that she could look directly to Mirkopoulos for payment of her account.

2. Did the trial judge err by rejecting the claim against Mirkopoulos based on collusion?

26 The trial judge found that the claims for fraud, collusion and conspiracy had not been made out. Her factual findings on these points are not challenged on appeal. The appellant argues, however, that a claim for collusion was made out on the facts that were proven, namely that (i) both Crossen and Mirkopoulos knew of the appellant's outstanding account, and (ii) the settlement agreement between Crossen and Mirkopoulos resolving their dispute failed to provide for the payment of that account. The appellant submits that liability for collusion is made out if the *effect* of the agreement was to deprive the appellant of the means to recover her account.

27 I disagree with that submission. The ingredients of collusion where dealt with by this court in *Gardiner Miller Arnold LLP v. Kymbo International Inc.* (2007), 33 B.L.R. (4th) 34 (Ont. C.A.). The court held, at para. 26, that collusion requires a finding that "there was an agreement between (the parties) to deprive (the law firm) of the fees to which it was entitled". This requires that one of the *purposes* of the agreement must have been to defeat the law firm's claims (paras. 40-51). *Gardiner* involved a secret deal whereby a client received monies that would not be disclosed to anybody, including his solicitors. Lang J.A., writing for the court, concluded that the object of the secret payment was to defeat the solicitor's claim and stated, at para. 56: "[i]t simply makes no sense for the [third party] to conceal its payment to [the client] unless it did so for the purpose of defeating [the solicitor's] claim."

28 We were also referred to *Price v. Crouch* (1891), 60 L.J.Q.B. 767 (Eng. Q.B.) where Denman J. described collusion as "an agreement between two parties with the knowledge that they are doing an unfair thing in depriving a third party of a right he had." In that case there was evidence that the client had entered negotiations with the opposite side to settle litigation with a view to getting better terms for himself and his opponent by way of an arrangement that would cut out his solicitor. The circumstances were described as follows by Wills J., at p. 769:

> It is obvious that if the plaintiff's solicitor's costs could be got rid of, better terms could be obtained by the defendant, and the bargain was made with that object. Both the plaintiff and the solicitors for the defendant were well aware that a considerable sum for costs was due, and their conduct shows that they desired to defeat the applicant's claim for them. The defendant's solicitors knew that they could get better terms for their client from the plaintiff if he left his solicitor out in the cold.

29 *Dicarllo v. McLean* (1915), 33 O.L.R. 231 (Ont. C.A.) (S.C. (A.D.)) is to the same effect. Collusion is made out where the court is satisfied that the *object or purpose* of the agreement was to deprive the solicitor of his fees. In that case, going behind the backs of both his own solicitor and that of the plaintiff, the defendant arranged for the plaintiff, an impecunious Italian labourer, to be taken to another town where he was paid a relatively small sum to settle the case. The plaintiff immediately returned to Italy. Middleton J. concluded that collusion was made out, at p. 235:

> [The defendant] knew that the costs were heavy. He desired to end the litigation with the least possible expenditure of money. He knew that the plaintiff could not have paid his solicitors. He knew that the plaintiff, when given this money, would not pay his solicitors. He was ready to assist the plaintiff to leave the country without discharging his obligation. He displayed that reckless disregard for the rights of others which amounts to dishonesty, and he acquiesced in, if he did not suggest, the plaintiff's dishonesty

30 In my view, the appellant's submission that collusion was made out merely by showing that the settlement that Crossen and Mirkopoulos reached failed to provide for the payment of the appellant's account cannot be accepted. That submission is not supported by the authorities to which I have referred and I see no reason in the circumstances of this case to relax the test for collusion that is set out in those cases. Here, Crossen, the weaker party, initiated the settlement discussions. This was not a secret or back door arrangement designed to leave the appellant out in the cold but rather a settlement reached at a judge-supervised settlement conference. Crossen testified that she raised the matter of the appellant's account with the judge who conducted the settlement conference and was told "that is something the lawyer will obviously take care of and it will come up against me."

31 It was clearly open to Mirkopoulos to say that he would pay $33,000 to settle the case and no more and to leave the matter of the appellant's account to be dealt with as between Crossen and the appellant. His solicitor testified at trial that it was his opinion that given the very short duration of the marriage, Mirkopoulos had already overpaid Crossen in support and owed her nothing by way of equalization. In view of that legal advice, it is difficult to see how the manner in which Mirkopoulos settled the litigation could be described as collusive. I also agree with the submission made by counsel for Mirkopoulos that if the appellant's submission were accepted, the effect would be to force impecunious litigants to reject any settlement that did not cover their legal costs.

32 Accordingly, I would dismiss the appeal from the trial judge's dismissal of the claim for collusion

3. Did the trial judge err by reducing the appellant's account to $50,000?

33 As I would allow the cross-appeal and dismiss the judgment against Mirkopoulos for the appellant's account, and as the appellant seeks no further relief against Crossen, it is not necessary for me to consider whether the trial judge erred by reducing the appellant's account to $50,000. I should not, however, be taken as agreeing with the trial judge's "blunt pencil" approach to the assessment of the account.

Conclusion

34 For these reasons, I would dismiss the appeal, allow the cross-appeal and set aside paragraph one of the judgment as against Mirkopoulos. The respondent was awarded costs of the trial and I would not alter that award. The respondent is entitled to his costs of this appeal fixed at $10,000, inclusive of disbursements and GST.

Appeal dismissed; cross-appeal allowed.

Footnotes

* Corrigendum issued by the Court on May 25, 2009 has been incorporated herein.

End of Document

TAB 7

2001 CarswellOnt 3893
Ontario Superior Court of Justice [Commercial List]

Playdium Entertainment Corp., Re

2001 CarswellOnt 3893, [2001] O.J. No. 4252, 109 A.C.W.S. (3d) 207, 18 B.L.R. (3d) 298, 31 C.B.R. (4th) 302

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

In the Matter of a Plan of Compromise or Arrangement of Playdium Entertainment Corporation et al.

Spence J.

Heard: October 29 and 30, 2001
Judgment: November 2, 2001 *
Docket: 01-CL-4037

Proceedings: additional reasons at [2001] CarswellOnt 4109 (Ont. S.C.J. [Commercial List])

Counsel: *Paul G. Macdonald, Alexander L. MacFarlane*, for Covington Fund I Inc.
Gary C. Grierson, J. Anthony Caldwell, for Famous Players Inc.
Craig J. Hill, for Pricewaterhouse Coopers Inc.
Roger Jaipargas, for Monitor
Gavin J. Tighe, for Toronto-Dominion Bank
Michael B. Rosztain, for Canadian Imperial Bank of Commerce
Geoff R. Hall, for Ontario Municipal Employees Retirement Board
David B. Bish, for Playdium Entertainment Corporation
Julian Binavince, for Cambridge Shopping Centres Limited

Subject: Corporate and Commercial; Insolvency

Headnote

Corporations --- Arrangements and compromises — Under Companies' Creditors Arrangement Act — Miscellaneous issues

Group of corporations which operated chain of cinemas attempted restructuring under Companies' Creditors Arrangement Act, but no viable plan was arrived at — Corporations proposed that all their assets be transferred to new corporation, to be indirectly controlled by corporations' two primary secured creditors — Transaction would involve assignment of all material contracts of business, including agreement with film distribution company — Corporations were not in compliance with agreement, but proposed that new corporation would take steps to achieve compliance — Corporations brought application for court approval of proposed transfer — Application granted — Interim receiver appointed — Corporations did not have right to make assignment pursuant to s. 35 of agreement, because transfer was not to "affiliate" and film distribution company's consent to transfer was not unreasonably withheld — Film distribution company was entitled to look for better deal elsewhere in view of corporations' ongoing non-compliance with agreement — Court had jurisdiction to approve transfer, however, by reason of Companies' Creditors Arrangement Act — Appropriate to approve transfer in circumstances — Corporations had made sufficient effort to obtain best price and had not acted improvidently — Proposal took into account interests of trade creditors, employees and members of public — There had been no unfairness in process by which offer was obtained — Right of film production company to seek relief for default under agreement adequately addressed risk of new corporation's continuing non-compliance — Fact that film production company

could obtain better deal with another entity did not furnish reason to refuse to approve transfer, especially since propriety of alternate transaction was in dispute — If transfer were not approved, likely that corporations would go into bankruptcy.

Table of Authorities

Cases considered by *Spence J.*:

Canada (Minister of Indian Affairs & Northern Development) v. Curragh Inc. (1994), 27 C.B.R. (3d) 148, 114 D.L.R. (4th) 176 (Ont. Gen. Div. [Commercial List]) — considered

Canadian Red Cross Society / Société Canadienne de la Croix-Rouge, Re (1998), 5 C.B.R. (4th) 299 (Ont. Gen. Div. [Commercial List]) — followed

Dominion Stores Ltd. v. Bramalea Ltd. (1985), 38 R.P.R. 12 (Ont. Dist. Ct.) — considered

GATX Corp. v. Hawker Siddeley Canada Inc. (1996), 1 O.T.C. 322, 27 B.L.R. (2d) 251 (Ont. Gen. Div. [Commercial List]) — referred to

Lehndorff General Partner Ltd., Re (1993), 17 C.B.R. (3d) 24, 9 B.L.R. (2d) 275 (Ont. Gen. Div. [Commercial List]) — referred to

T. Eaton Co., Re (1999), 14 C.B.R. (4th) 298 (Ont. S.C.J. [Commercial List]) — referred to

Statutes considered:

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

APPLICATION by corporations for approval of proposed transfer of assets.

***Spence J.*:**

1 These reasons are provided in brief form to accommodate the exigencies of this matter.

2 The Playdium corporations and entities (the "Playdium Group") have been engaged in restructuring efforts under the *Companies' Creditors Arrangement* Act (the "*CCAA*"). These efforts have been unsuccessful. It is now proposed that substantially all the Playdium assets will be transferred to a new corporation ("New Playdium") which will be indirectly controlled by Covington Fund I Inc. and Toronto-Dominion Bank. This transfer would be made in satisfaction of the claims of those two creditors and Canadian Imperial Bank of Commerce, the primary secured creditors and the only creditors with an economic interest in the Playdium Group.

3 The primary secured creditors intend that the Playdium Group's business will continue to be operated as a going concern. If successful, this would potentially save 300 jobs as well as various existing trade contracts and leases.

4 This transaction is considered to be the only viable alternative to a liquidation of Playdium Group and the adverse consequences that would flow from a liquidation. Interests of members of the public also stand to be affected, in respect of prepaid game cards and discount coupons, which are to be honoured by the new entity.

5 The proposed transaction would involve assignment to the new entity of the material contracts of the business, including the Techtown Agreement with Famous Players.

6 Playdium Group is not currently in compliance with the equipment supply provisions of s.9(e) of the Techtown Agreement. The new entity is to take steps, as soon as reasonably practicable, that are intended to achieve compliance with s.9(e). Famous Players disputes that the proposed steps will have that effect and opposes approval of the proposed assignment of the Techtown Agreement to the new entity.

7 Covington says that the assignment of the Techtown Agreement is a critical condition of the proposed transaction: without the assignment, the transaction cannot proceed.

8 Covington says that the structure of the proposed transaction is such that it does not require the consent of Famous Players. This is disputed by Famous Players, based on s.35 of the Agreement and the fact that the assignee is to be controlled by Covington and TD Bank.

9 Covington submits that it is in the best interests of all the shareholders that the proposed transaction, including the assignment of the Techtown Agreement, be implemented. Covington and TD Bank seek an order authorising the assignment and precluding termination of the Techtown Agreement by reason only of the assignment or certain defaults. Famous Players has not given any notice of default to date. The prohibition against termination for default is not to apply to a continuing default under para.9(e) of the Agreement.

10 The primary secured creditors also seek an extension of the existing stay until November 29, 2001 to finalize these transactions. To facilitate the transactions, Covington and TD Bank seek the appointment of Pricewaterhouse Coopers as Interim Receiver.

11 Based on the cases cited, including *Lehndorff General Partner Ltd., Re* (1993), 17 C.B.R. (3d) 24 (Ont. Gen. Div. [Commercial List]), *Canadian Red Cross Society / Société Canadienne de la Croix-Rouge, Re* (1998), 5 C.B.R. (4th) 299 (Ont. Gen. Div. [Commercial List]), and *T. Eaton Co., Re* (1999), 14 C.B.R. (4th) 298 (Ont. S.C.J. [Commercial List]), and the statutory provisions and text commentary cited, the court has the jurisdiction to grant the orders that are sought, and may do so over the objections of creditors or other affected parties. Also, the decision in *Canada (Minister of Indian Affairs & Northern Development) v. Curragh Inc.* (1994), 114 D.L.R. (4th) 176 (Ont. Gen. Div. [Commercial List]), supports the appointment of an interim receiver to do what "justice dictates" and "practicality demands".

12 Famous Players says that no reason has been shown to expect the proposed course of action will bring the Techtown Agreement into compliance and make it properly operational; Covington has not shown it has expertise to bring to the business operations; the operations are grossly in default at present, and the indicated plans are inadequate to cure the default, which has serious adverse consequences to Famous Players.

The Relief Sought

13 The applicants revised the form of order that they seek, to provide (in paragraph 15) that a counterparty to a Material Agreement is not to be prevented from exercising a contractual right to terminate such an agreement as a result of a default that arises or continues to arise after the filing of the Interim Receiver's transfer certificate following completion of the contemplated transactions.

14 Famous Players moved for certain relief that was apparently formulated before the applicants' revisions to their draft order. From the submissions made at the hearing, I understand the position of Famous Players to be that it opposes the order sought by the applicants, at least insofar as it would approve the assignment of the Techtown Agreement, but the submissions of Famous Players did not address specifically the relief sought in their notice of motion, presumably because of the revision to the applicants' draft order as regards continuing defaults.

Section 35 of the Techtown Agreement

15 Section 35 permits an assignment to a Playdium affiliate. The proposed assignee is to be a new company, "New Playdium", to be incorporated on behalf of the Playdium Group, and to be owned by it at the precise time when the assignment occurs. The assignment will occur, it may be presumed, if and only if the contemplated transactions of transfer are completed. On completion of the contemplated transactions, New Playdium will be owned by a corporation controlled by Covington and TD Bank. That outcome reflects the purpose of the assignment, which is to transfer the benefit of the Techtown Agreement to the new owners. Accordingly the assignment, viewed in terms of its substance and not simply its momentary constituent formalities, is not a transfer to a Playdium affiliate. This view is in keeping with the decision in *GATX Corp. v. Hawker Siddeley Canada Inc.* (1996), 27 B.L.R. (2d) 251 (Ont. Gen. Div. [Commercial List]).

16 Under s.35, the Agreement therefore may not be assigned without the consent of Famous Players, which consent may not be unreasonably withheld. Famous Players says that it has not been properly requested to consent and it has not received adequate financial information and assurances as to the provision of satisfactory management expertise and as to how the Agreement is to be brought into good standing.

17 The submission to the contrary is that the Agreement is really in the nature of a lease, not a joint venture involving the requirement for the provision to the venture of management services. This submission has some merit. Playdium seems principally to be required to supply game equipment. Section 26 of the Agreement disclaims any partnership or joint venture. If the business is to be sold to the new owners as a going concern, it would be likely to have the same competence as before, unless the contrary is shown, which is not so. Covington says that financial information was offered and not accepted and (although this is either disputed or not accepted) that no further request was made for it.

18 Reference was made to the decision in *Dominion Stores Ltd. v. Bramalea Ltd.* (1985), 38 R.P.R. 12 (Ont. Dist. Ct.) that an assignment clause of this kind is to be construed strictly, as a restraint upon alienation, and its purpose is to protect the landlord as to the type of business carried on. The case also says that a refusal for a collateral purpose or unconnected with the lease is unreasonable.

19 On the material filed, Famous Players has the prospect of a better deal with Starburst and this must be considered a factor in their withholding of consent. It is also relevant that Playdium is not in compliance with the Agreement and it is not clear how soon compliance is intended to be achieved under the Covington proposal. It is not clearly unreasonable for a party in the position of Famous Players to look for a better deal when the counterparty is in a condition of continuing non-compliance.

20 The propriety of the proposed Starburst deal is disputed on the basis of a possible breach of the Non-Disclosure Agreement between Starburst and Playdium. The relevance of this dispute is considered below.

Whether Court should approve the Assignment of the Techtown Agreement

21 This is the pivotal issue in respect of the motion.

22 Famous Players objects to the assignment. Famous Players refuses its consent. With regard to s.35 of the Agreement, and without reference to considerations relating to *CCAA* (which are dealt with below), I cannot conclude that the withholding of consent is unreasonable. So s.35 does not provide any right of assignment.

23 If there were no *CCAA* order in place and Playdium wished to assign to the proposed assignees, it would not be able to do so, in view of Famous Players' withholding of its consent. The *CCAA* order affords a context in which the court has the jurisdiction to make the order. For the order to be appropriate, it must be in keeping with the purposes and spirit of the regime created by *CCAA*: see the *Red Cross* decision.

The factors to be considered

24 The applicants submit that it is clear from the Monitor's reports that a viable plan cannot be developed under *CCAA* and the present proposal is the only viable alternative to a liquidation in bankruptcy. The applicants say that the present proposal has the potential to save jobs and to benefit the interests of other stakeholders.

25 Famous Players submits that, on the basis of the *Red Cross* decision, the court should approve the appointment of an interim receiver with power to vest assets, in a *CCAA* situation, where there is no plan, only where certain appropriate circumstances exist as set out in *Red Cross*, and those circumstances do not exist here.

26 In this regard, the first factor mentioned in *Red Cross* is whether the debtor has made a sufficient effort to obtain the best price and has not acted unprovidently. Famous Players says that there has been no substantial effort to develop a plan to sell the business components (such as the LBE's) as going concerns, no tender process, no marketing effort and no expert analysis. From the reports of the monitor it appears efforts were made to find prospects to purchase debt or equity or assets and there was no indication of viable deals. Whether or not the best price has been obtained, on the material it appears the value of the assets would not satisfy the claims of the principal secured creditors. There is nothing to suggest that a better deal could be done without including the Techtown Agreement; according to the monitor it would have been a key part of any viable plan. Famous Players is not in the position of a creditor looking to be paid out, so its submissions as to the need to get the best price do not seem to be well addressed to its proper interest in this case, and the others who have appeared who are creditors are not objecting to the process and the result.

27 The second factor mentioned in the *Red Cross* decision is that the proposal should take into consideration the interests of the parties. The proposal has potential benefits for trade creditors, employees and members of the public which would flow from continuing the business operations as proposed.

28 The other two criteria in *Red Cross* are that the court is to consider the efficacy and integrity of the process by which the offers were obtained and whether there has been unfairness in the working out of the process. Famous Players says that, as regards its interests, there has been no participation afforded to it in designing the proposal, although the Techtown Agreement is said to be critical to the proposal, and nothing to show how or when the s.9(e) requirements will be brought into compliance. There were discussions between the parties in August but they did not lead to any productive result. It is true that it is not clear how or when compliance will be brought about. This point is considered below.

The effect on Famous Players

29 Famous Players says that if the applicants are given the relief they seek, the proposed transactions will close and the *CCAA* stay will be lifted — which would happen at the end of November, on the present proposal — and the prospect would be that Famous Players would then issue notices of default in respect of s.9(e), notice of termination would follow and the entire matter would end up in litigation within two months. That is possible. It is also possible that the parties would work out a deal. Covington is to invest about $3 million in the new entity so there will be an incentive for it to find ways to make the new business work.

30 If the parties cannot resolve their differences, then litigation might well result. Famous Players would be saved that prospect if the assignment were not to be approved and the companies instead were liquidated in bankruptcy. The delay occasioned by a further stay and subsequent litigation would also presumably result in increased losses of revenue to Famous Players compared to a full compliance situation or an immediate termination. There is nothing before the court to suggest that, if Famous Players has to resort to litigation and succeeds, it would not be able to recover from the new company. On this basis, the right of Famous Players to seek relief for a default seems to address adequately the risk of continuing non-compliance with s.9(e). Accordingly, the provision preserving that right is a key consideration in favour of the motion.

31 The other reason Famous Players evidently has for opposing the applicants' motion is that it could do a better deal with Starburst. If that were the only reason it had for withholding consent to an assignment of the Agreement, it would not be a reasonable basis for withholding consent under s.35 of the Agreement. It can be inferred from that consideration

that it should also not be regarded as, by itself, a proper reason to allow the objection to stand in the way of the proposed assignment as part of the proposal to enable the business to continue.

32 Moreover, as noted above, the propriety of the Starburst transaction is disputed, on the basis of a possible breach of the Non-Disclosure Agreement between Starburst and Playdium. Based on the submissions before the court, the dispute could not be said to be without substance. If the proposed transactions are allowed to proceed and litigation ensues between Famous Players and New Playdium, there would presumably also be an opportunity for the dispute about the possible breach, and its implications for the propriety of the proposed deal between Starburst and Famous Players, to be pursued in litigation.

33 If instead the proposed transactions are precluded by a denial of the requested order, Playdium would go into bankruptcy and it would lose any opportunity to obtain the benefit of any rights it would otherwise have to oppose the proposed deal between Starburst and Famous Players. Allowing the Playdium transactions to proceed would effectively preserve those rights.

Conclusion

34 For the above reasons the motion of the applicants is granted. The initial order of this court made February 22, 2001 shall be continued to November 29, 2001, and the stay period provided for therein shall be extended to November 29, 2001. The parties may consult me about the other terms of the order, and costs.

Application granted.

Footnotes

* Additional reasons at 2001 CarswellOnt 4109, 31 C.B.R. (4th) 309 (Ont. S.C.J. [Commercial List]).

2001 CarswellOnt 4109
Ontario Superior Court of Justice [Commercial List]

Playdium Entertainment Corp., Re

2001 CarswellOnt 4109, [2001] O.J. No. 4459, [2001] O.T.C. 828, 109 A.C.W.S. (3d) 683, 31 C.B.R. (4th) 309

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

In the Matter of a Plan of Compromise or Arrangement of Playdium Entertainment Corporation et al.

Spence J.

Heard: November 9, 2001
Judgment: November 15, 2001
Docket: 01-CL-4037

Proceedings: additional reasons to (2001), 18 B.L.R. (3d) 298 (Ont. S.C.J.)

Counsel: *Paul G. Macdonald*, for Covington Fund I Inc.
Gary C. Grierson, for Famous Players Inc.
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David B. Bish, for Playdium Entertainment Corporation

Subject: Corporate and Commercial; Insolvency

Headnote

Corporations --- Arrangements and compromises — Under Companies' Creditors Arrangement Act — Arrangements — Approval by court — Miscellaneous issues

Group of corporations which operated chain of cinemas was unable to arrive at viable plan while restructuring under Companies' Creditors Arrangement Act — Corporations, including bankrupt corporation, proposed transfer of assets to new corporation — Transaction would involve assignment of agreement with film distribution company — Corporations' application for court approval of assignment was granted and interim receiver was appointed — Creditors proposed that order appointing interim receiver contain certain provisions — Company submitted that form of order should be revised to provide that transfer of assets be made subject to any and all claims of company arising from contractual entitlements under agreement — Clause requested by company was not necessary — Pursuant to terms of assignment, company would continue to have same rights of action it currently had or that could subsequently arise against bankrupt corporation — Sections 11(4)(a), (b) and (c) of Act only provide for orders of negative injunctive effect, unless otherwise ordered by court, in respect of proceedings against bankrupt company — Circumstances of company with respect to agreement had not changed to company's detriment — In principle, change, occasioned only by change in ownership, did not involve materially greater or different obligations and was within jurisdiction of Act — Court prohibits any proceeding by company against bankrupt corporation except on terms such that proceeding be consistent with any assignment of agreement approved by court — Order on such terms conforms to requirements of s. 11(4)(c) — If order did not bind company in positive manner, company could assert rights under agreement without being subject to corresponding obligations — Approval of proposed assignment was within court's jurisdiction and was proper exercise of jurisdiction — Companies' Creditors Arrangement Act, R.S.C. 1985, c. C-36, ss. 11(4)(a), (b), (c).

Table of Authorities

Cases considered by *Spence J.*:

American Eco Corp., Re (October 24, 2000), Doc. 00-CL-3841 (Ont. S.C.J.) — considered

Canada (Minister of Indian Affairs & Northern Development) v. Curragh Inc. (1994), 27 C.B.R. (3d) 148, 114 D.L.R. (4th) 176 (Ont. Gen. Div. [Commercial List]) — followed

Canadian Red Cross Society / Société Canadienne de la Croix-Rouge, Re (1998), 5 C.B.R. (4th) 299 (Ont. Gen. Div. [Commercial List]) — considered

Lehndorff General Partner Ltd., Re (1993), 17 C.B.R. (3d) 24, 9 B.L.R. (2d) 275 (Ont. Gen. Div. [Commercial List]) — considered

Smoky River Coal Ltd., Re, 1999 CarswellAlta 491, 175 D.L.R. (4th) 703, 237 A.R. 326, 197 W.A.C. 326, 71 Alta. L.R. (3d) 1, [1999] 11 W.W.R. 734, 12 C.B.R. (4th) 94 (Alta. C.A.) — considered

Statutes considered:

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

s. 11(3) — considered

s. 11(4) — considered

s. 11(4)(a) — referred to

s. 11(4)(b) — referred to

s. 11(4)(c) — considered

ADDITIONAL REASONS to judgment reported at 2001 CarswellOnt 3893, 18 B.L.R. (3d) 298, 31 C.B.R. (4th) 302 (Ont. S.C.J.), disallowing film distribution company's proposed revision to form of order.

***Spence J.*:**

1 These reasons are supplemental to the reasons for decision which I released November 2, 2001. Reference is made to those reasons. The defined terms employed in those reasons are also used below.

2 Covington and TD Bank propose that the order appointing the interim receiver should contain, as regards the assignment of the Material Agreements (including the Techtown Agreement), the provisions set out in Part V, paragraphs 10 through 13, of the draft order now before the court.

3 This draft order is different from the form of order in the motion record but apparently not different in respect of the matter now in issue between Covington, TD Bank and Playdium on the one side and Famous Players on the other. The hearing on October 29 and 30 did not address the specific terms of the order but it did address the intended effect of the assignment of the Techtown Agreement. It was submitted that the assignment was intended to result in New Playdium, as assignee, becoming bound to perform the Playdium obligations under the agreement from and after the transfer date and becoming entitled to obtain performance by Famous Players of its obligations under the agreement from and after that

date. Special provision has been made in respect of s.9(e) defaults, as referred to in the reasons for decision of November 2, 2001. The insolvency defaults of Playdium which led to the CCAA order are in effect stayed, which is not an issue.

The Issue

4 Famous Players now submits that the form of order should be revised to provide that the transfer of assets should, in effect, be made subject to "any and all claims of Famous Payers arising from its contractual entitlements under the Techtown Agreement".

5 Famous Players submits that a provision to that effect is necessary because otherwise it will suffer the loss of certain of those claims and that it ought not to be deprived of those claims by the order of the court and that the court has no jurisdiction to make such an order.

The Terms of the Assignment

6 Famous Players will continue to have any rights of action it now has or which may subsequently arise in its favour against Playdium (subject to any subsequent court determination to the contrary), because nothing in the proposed transaction purports to alter those rights. It is not indicated whether Playdium is to have liability in respect of events occurring after the transfer. In any event, the continuing liability of Playdium is of no practical consequence to Famous Players' concerns, given Playdium's insolvency.

7 As against New Playdium, by reason of paragraph 13 of the draft order, Famous Players would be able to exercise a contractual right to terminate as a result of a default that arises or continue to exist after the transfer, except for an insolvency default.

8 Counsel for Covington said that if there is an existing misrepresentation as to the state of the equipment, that would be brought forward, which I take to mean that the rights of Famous Players in that respect would be preserved for purposes of Famous Players being able to assert those rights against New Playdium.

9 It was submitted that the proposed terms in the draft order would assign the benefit of the agreement without the burden. However, on the basis of the material and the submissions for Covington and TD Bank, the intention is that New Playdium would assume the burden of the agreement as of and from the transfer date in respect of the obligations of performance then in effect or arising subsequently.

10 What New Playdium would not assume or be liable for would be any claims that may arise in the future in favour of Famous Players against Playdium in respect of matters which occurred prior to the transfer and do not constitute a continuing default on the part of Playdium at the time of the transfer.

11 An example of such a contingent claim might be a claim for indemnity by Famous Players against Playdium in respect of damages payable by Famous Players for injury suffered resulting from Playdium's equipment in an occurrence prior to the transfer to New Playdium but not asserted by the claimant until a time subsequent to the transfer. It was submitted that such a claim cannot properly be viewed as part of the continuing burden of the agreement as regards New Playdium because the event giving rise to it antedates New Playdium's involvement. It was also submitted that such a claim is nothing other than a contingent unsecured claim of a person who, in respect of the claim, is a creditor or prospective creditor of Playdium and the claim should not be entitled to any different recognition than other unsecured contingent claims of Playdium. These submissions have merit.

12 For Famous Players it was submitted that New Playdium is seeking to take an assignment of the agreement without being subject to the equities. However, it appears that Famous Players' rights of termination are preserved (except for the insolvency default), in respect of defaults under the agreement existing at or subsequently arising after the transfer date.

13 It was not suggested that New Playdium seeks to take an assignment from Playdium of rights against Famous Players in respect of matters that have occurred previously under the agreement and which might be the subject of a claim

of set-off or counterclaim. If that were intended, that might well constitute a case of assignment without being subject to the equities. For that reason, it would be appropriate that New Playdium should not be able to assert such rights against Famous Players without being subject to any such claims (i.e. set-offs and counterclaims) of Famous Players relating to such rights. A provision to that effect ought to be included in the order and it should state that the provision is subject to any further order of the court based on CCAA consideration.

Jurisdiction of the Court Under CCAA

14 As for the jurisdiction of the court to order the assignment on the terms proposed, Famous Players submits that the authority of the court must derive from the CCAA and there is no provision in the CCAA sufficient for this purpose. This raises an issue of fundamental importance about the scope of the CCAA.

15 Section 11(4) of CCAA provides as follows:

> Other than initial application court orders — a court may, on an application in respect of a company other than an initial application, make an order on such terms as it may impose.
>
> (a) staying, until otherwise ordered by the court, for such period as the court deems necessary, all proceedings taken or that might be taken in respect of the company under an Act referred to in subsection (1);
>
> (b) restraining, until otherwise ordered by the court, further proceedings in any action, suit or proceeding against the company; and
>
> (c) prohibiting until otherwise ordered by the court, the commencement of or proceeding with any other action, suit or proceeding against the company.

16 Famous Players now submits that s. 11(4) of the CCAA is not sufficient to give the court authority to make an order which has a permanent effect against a third party and that no other provision of the CCAA assists and neither does the inherent jurisdiction of the court.

17 As the parties presumably realize, the submission of Famous Players goes not just to the terms proposed but to the jurisdiction of the court to order the assignment itself, a matter that was dealt with in the reasons of November 2, 2001. Since the order has not yet been taken out, the matter is still before me. Because of the importance of the issue, it is appropriate to consider the further submissions made at the present hearing.

The Case Law

18 The following excerpts from decisions in cases under the CCAA provide assistance in assessing the extent of the jurisdiction of the court.

19 From *Lehndorff General Partner Ltd., Re* (1993), 17 C.B.R. (3d) 24 (Ont. Gen. Div. [Commercial List]) at pages 33 and 34, by Farley J.; with reference to s. 11 of the Act as it was at that time:

> 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 *Meridan Developments Inc. v. Toronto Dominion Bank*, supra, pp. 219 ff.

> 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 Metropolitain v. Wynden* and *Qintette Coal Ltd. v. Nippon Steel Corp.*, supra, at pp. 311-312 (B.C.C.A.).

20 From *Canadian Red Cross Society / Société Canadienne de la Croix-Rouge, Re* (1998), 5 C.B.R. (4th) 299 (Ont. Gen. Div. [Commercial List]) at page 315, by Blair J:

> The CCAA is designed to be a flexible instrument, and it is that very flexibility which gives it its efficacy. As Farley J. said in *Dylex Ltd.*, supra (p. 111), "the history of CCAA law has been an evolution of judicial interpretation". It is not infrequently that judges are told, by those opposing a particular initiative at a particular time, that if they make a particular order that is requested it will be the first time in Canadian jurisprudence (sometimes in global jurisprudence, depending upon the level of the rhetoric) that such an order has made! Nonetheless, the orders are made, if the circumstances are appropriate and the orders can be made within the framework and in the spirit of the CCAA legislation.

21 From the endorsement in *American Eco Corp., Re* (October 24, 2000), Doc. 00-CL-3841 (Ont. S.C.J.), unreported Endorsement of Farley J.:

> The only fly in the ointment as I was advised was that BFC was not agreeable to giving its consent, which consent is not to be unreasonably withheld as to the transfer of the j.v. contract participation from Industra to members of the Lockerbie Group...
>
> Thus it appears to me that in relative terms, the financial aspects of this transfer vis a vis the joint venture is covered off by the asset/equity substance of the consolidated Lockerbie group and the provision of the completion bond. As well from a work performance aspect, one should note that if Lockerbie was not allowed the transfer, then BFC would be looking at an insolvent j.v. venturer Industra — with the result that as opposed to the Industra team being kept together (as assumed by Lockerbie purchasers), the team would be "let go" and BFC would not have this likely package but would have to go after the disintegrated team on a one by one basis.
>
> But perhaps more telling is the BFC October 12/2000 letter that "Therefore, we would only be prepared to seventy five (75) percent". Thus it appears that there is no financial or operational reason to refuse the assignment — but merely, a bonus which in my view is not related to any true risk — but merely a "bare consideration" bonus. See paragraph 194 of *Welch Foods v. Cadbury Beverages Canada Inc.* I find that BFC would be unreasonable to withhold its consent if the Lockerbie group provided the aforesaid guarantees and bond.
>
> While it is true that the assignment provision is there irrespective of it being in an insolvency setting or not, it would seem to me that in the fact circumstances prevailing of the insolvency that BFC is attempting to confiscate value which should otherwise be attributable to the creditors.

22 Famous Players is not seeking a bonus for its consent. But its only apparent remaining reason for withholding consent, vis a vis the prospect now afforded of a solvent Playdium business under the new owners, is that it has a better prospective deal with Starburst, which is not dissimilar to the Industra situation.

23 From *Smoky River Coal Ltd., Re*, [1999] A.J. No. 676 (Alta. C.A.) at pages 10 and 13 by Hunt J.A.

> 47 The Appellants do not dispute that the rights of non-creditor third parties can be affected by the s. 11 power to order a stay. They agree this is the clear implication of cases such as Norcen, supra, a decision that has been followed widely and cited with approval by many Canadian courts. But they say in no case has a court altered permanently the contractual rights of a non-creditor and doing so is beyond the scope of the CCAA...
>
> 49 ...Although there are no previous decisions on all fours with the present situation, I read the existing jurisprudence as supportive of my interpretation of s. 11(4).

> 50 The language of s. 11(4) is very broad. It allows the court to make an order "on such terms as it may impose". Paragraphs (a), (b) and (c) empowers the court order to stay "all proceedings taken or that might be taken" against the debtor company; restrain further proceedings "in any action, suit or proceedings" against the debtor company; and prohibit "the commencement of or proceeding with any other action, suit or proceeding" (emphasis added). These words are sufficiently expansive to support the kind of discretion exercised by the chambers judge.
>
> 72 ...I do not consider that the order under appeal permanently affects the substantive contractual rights of the parties. It merely affects the forum in which those contractual rights will be assessed. This is a relatively minor incursion compared to the large benefit that may result from the CCAA proceedings. I assume that, in setting the details of the CCAA procedure, the chambers judge will take account of the Appellants' arguments and ensure that their substantive contractual rights are protected.

24 Paragraph 72 of the *Luscar* decision appears to me not to intend a limitation on the scope of the authority of the court as characterized in paragraph 50, but rather as an expression of the need for caution as to the manner in which that jurisdiction is exercised.

25 It appears to me that the approach taken by courts to the CCAA in the decided cases to which I have been referred is consistent, in terms of the views expressed about the proper application of the Act and the decisions taken in the particular cases, with the approval that is sought here for the assignment of the Techtown Agreement.

Analysis

26 Section 11(4) of the CCAA, in subsections (a) (b) and (c), provides only for orders of a negative injunctive effect until otherwise ordered by the court, in respect of proceedings against the company, i.e. in this case, Playdium. However, the order sought is in effect to require Famous Players to be bound by an assignment of their agreement to New Playdium. It is not readily apparent how such an order could be made under s.11(4) (a)(b) or (c) of the CCAA and no other section of the Act has been mentioned as relevant.

27 Section 11(4)(c) warrants further consideration in this regard. Section 11(4) (c) does not require that an order be made only for a limited period, as s.11(4)(a) appears to do. By its terms it would seem to permit an order to prohibit the commencement of any action, suit or proceeding against Playdium on the basis of the Techtown Agreement including the purported assignment of the agreement to New Playdium. Such an order would seem to be legitimate in its formal compliance with s. 11(4) (c) but it would leave the matter of the status of the Techtown Agreement unresolved with respect to all concerned, unless it could go on, through an ancillary order, to give effective approval to the assignment.

28 Consideration must also be given to the words, in the opening part of s. 11(4) which provide that the court may make an order *on such terms as it may impose* (emphasis added).

29 It is instructive to compare s.11(4) of the CCAA with s.11(3). Section 11(3), relating to initial application court orders also provides that the order may be made on such terms as the court may impose, but the provision adds the qualification "effective for such period as the court deems necessary not exceeding thirty days".

30 It is relevant to the analysis of this issue that Famous Players is not a mere "third party" but is, as counsel said, a significant stakeholder. Under the proposed transaction, Famous Players will retain its rights against Playdium in respect of claims relating to the pre-transfer period and will be entitled to assert, in respect of the period from and after transfer, the same rights against New Playdium as it had against Playdium, including rights to terminate for default, except the insolvency default which occasioned and was the subject of the CCAA stay. So it is difficult to see how the circumstances of Famous Players in respect of the Techtown Agreement could be said to have changed to the detriment of Famous Players in any material way.

31 In substance, what will have happened, to put the matter in terms of s.11(4), is that Famous Players will have been prohibited from taking proceedings in respect of the Techtown Agreement except on and subject to the terms of the assignment to New Playdium and to make that order effective terms will have been imposed by the court which provide for the Techtown Agreement to be assigned by the required date to New Playdium on terms that assure to Famous Players the same rights against New Playdium as it had against Playdium for the post-transfer period and leave Famous Players with its rights against Playdium in respect of the pre-transfer period.

32 In interpreting s. 11(4), including the "such terms" clause, the remedial nature of the CCAA must be taken into account. If no permanent order could be made under s. 11(4) it would not be possible to order, for example, that the insolvency defaults which occasioned the CCAA order could not be asserted by Famous Players after the stay period. If such an order could not be made, the CCAA regime would prospectively be of little or no value because even though a compromise of creditor claims might be worked out in the stay period, Famous Players (or for that matter, any similar third party) could then assert the insolvency default and terminate, so that the stay would not provide any protection for the continuing prospects of the business. In view of the remedial nature of the CCAA, the court should not take such a restrictive view of the s. 11(4) jurisdiction.

33 Famous Players objects that the order is not only permanent but positive, i.e. rather than simply restraining Famous Players, the order places it under new obligations. It would be more precisely correct to say that the order places Famous Players under the same obligations as it had before but in favour of the new owners of the business. Moreover, the new owners are not third parties but rather the persons who have the remaining economic interests in Playdium.

34 In view of the remedial nature of the CCAA, it does not seem that in principle, a change of this kind, which is a change occasioned only by the ownership changes effected by the compromise itself and one that does not involve any materially greater or different obligations, should be regarded as beyond the jurisdiction created by the CCAA. This view is examined further below with respect to the issue of positive obligations.

The Imposition of Positive Obligations

35 The requested approval of the assignment can be analyzed conceptually as follows in terms of s. 11(4)(c). The court prohibits any proceedings by Famous Players against Playdium (and therefore against its assignees) except on the following terms, i.e., that any such proceeding must be consistent with any assignment of the Agreement approved by the court. It is a further term, or an order to give effect to the stated terms, that the court approves the assignment to New Playdium for this purpose. An order on these terms conforms to the requirements of s. 11(4)(c).

36 Famous Players objects that the order is also to have positive effect: i.e. it imposes obligations on Famous Players as distinct from merely staying proceedings by it. However, the order as analyzed above could not be effective unless the assignment binds all parties, i.e. Famous Players as well as New Playdium and Playdium.

37 Also, if the order could not bind Famous Players in a positive manner, the result would be that Famous Players could assert rights under the Agreement as assigned but would not be subject to the corresponding obligations under it. This would not be fair.

38 So it is necessary for the order to have such positive effect if the jurisdiction of the court to grant the order under s.11(4)(c) is to be exercised in a manner that is both effective and fair. To the extent that the jurisdiction to make the order is not expressed in the CCAA, the approval of the assignment may be said to be an exercise by the court of its inherent jurisdiction. But the inherent jurisdiction being exercised is simply the jurisdiction to grant an order that is necessary for the fair and effective exercise of the jurisdiction given to the court by statute.

39 Reference has been made in CCAA decisions to the inherent jurisdiction of the court in CCAA matters. The following excerpt from the decision of Farley J. in *Canada (Minister of Indian Affairs & Northern Development) v. Curragh Inc.* (1994), 114 D.L.R. (4th) 176 (Ont. Gen. Div. [Commercial List])at pp 184 and 185 is instructive:

Certainly the non-bankruptcy courts of this country have exercised their inherent jurisdiction to bar claims against specified assets and receivers: see *Ultracare Management Inc. v. Gammon*, order of Austin J. dated October 19, 1993; *Liquidators of Wallace Smith Trust Co. Ltd. v. Dundalk Investment Corp. Ltd.*, order of Blair J. dated September 22, 1993. As MacDonald J. said in *Re Westar Mining Ltd.* (1992), 14 C.B.R. (3d) 88 at p. 93, [1992] 6 W.W.R. 331, 70 B.C.L.R. (2d) 6 (S.C.):

> I have concluded that "justice dictates" they should, and that the circumstances call for the exercise of this court's inherent jurisdiction to achieve that end: see *Winnipeg Supply & Fuel Co. v. Genevieve Mortgage Corp.*, [1972] 1 W.W.R. 651, 23 D.L.R. (3d) 160 (Man. C.A.), at p. 657 [W.W.R.].
>
> The circumstances in which this court will exercise its inherent jurisdiction are not the subject of an exhaustive list. The power is defined by *Halsbury's* (4th ed., vol. 37, para. 14) as:
>
> > ...the reserve or fund of powers, a residual source of powers, which the court may draw upon as necessary whenever it is just or equitable to do so...
>
> Proceedings under the C.C.A.A. are a prime example of the kind of situations where the court must draw upon such powers to "flesh out" the bare bones of an inadequate and incomplete statutory provision in order to give effect to its objects.

In commenting on this decision and discussing the stay provisions of the *Companies' Creditors Arrangement* Act, R.S.C. 1985, c. C-36 ("CCAA") and the *U.S. Bankruptcy* Code, Tysoe J. observed in *Re Woodward's Ltd.* (1993), 17 C.B.R. at pp. 247-8, [1993] B.C.J. No. 42:

> Hence it is my view that the inherent jurisdiction of the Court can be invoked for the purpose of imposing stays of proceedings against third parties. However, it is a power that should be used cautiously. In *Westar* Macdonald J. relied upon the Court's inherent jurisdiction to create a charge against Westar's assets because he was of the view that Westar would have no chance of completing a successful reorganization if he did not create the charge. I do not think that it is a prerequisitive to the Court exercising its inherent jurisdiction that the insolvent company will not be able to complete a reorganization unless the inherent jurisdiction is exercised. But I do think that the exercise of the inherent jurisdiction must be shown to be important to the reorganization process.
>
> In deciding whether to exercise its inherent jurisdiction the Court should weigh the interests of the insolvent company against the interests of the parties who will be affected by the exercise of the inherent jurisdiction. If, in relative terms, the prejudice to the affected party is greater than the benefit that will be achieved by the insolvent company, the court should decline to exercise its inherent jurisdiction. The threshold of prejudice will be much lower than the threshold required to persuade the Court that it should not exercise its discretion under s.11 of the CCAA to grant or continue a stay that is prejudicial to a creditor of the insolvent company (or other party affected by the stay).

40 It should be noted that orders made under s.11(4)(c) are to be made "until otherwise ordered by the court". A proviso to this effect (e.g. "subject to any further order of the court pursuant to s.11(4) (c) of the CCAA") should be included in any vesting order to be made in favour of New Playdium with respect to the assignment of the Techtown Agreement.

Whether the Order is Appropriate

41 The circumstances that are relevant in the present case are dealt with in the earlier reasons at paragraphs 24 through 33 and in the preceding paragraphs of the present reasons.

Conclusion

42 Having regard to the overall purpose of the Act to facilitate the compromise of creditors' claims, and thereby allow businesses to continue, and the necessary inference that the s. 11(4) powers are intended to be used to further that purpose, and giving to the Act the liberal interpretation the courts have said that the Act, as remedial legislation should receive for that purpose, the approval of the proposed assignment of the Terrytown Agreement can properly be considered to be within the jurisdiction of the court and a proper exercise of that jurisdiction.

43 Provided that terms are added to the assignment and to the vesting order to the effect directed above, Famous Players will not be subjected to an inappropriate imposition or to an inappropriate loss of claims, having regard to the purpose and spirit of the regime created by CCAA and my reasons for decision of November 2, 2001.

44 Accordingly, it is appropriate for the assignment to be approved and it is not necessary to add the clause requested by Famous Players to the form of order now before the court.

45 Counsel may consult me about costs.

Order accordingly.

TAB 8

2009 CarswellOnt 8071
Ontario Superior Court of Justice

Nexient Learning Inc., Re

2009 CarswellOnt 8071, [2009] O.J. No. 5507, 183 A.C.W.S. (3d) 636, 62 C.B.R. (5th) 248

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 Nexient Learning Inc. and Nexient Learning Canada Inc.

H.J Wilton-Siegel J.

Heard: November 30, 2009
Judgment: December 23, 2009
Docket: CV-09-8257-00CL

Counsel: George Benchetrit for Nexient Learning Inc., Nexient Learning Canada Inc.
Margaret Sims, Arthi Sambasivan for Global Knowledge Network (Canada) Inc.
Catherine Francis, David T. Ullman, Melissa McCready for ESI International Inc.
Lynne O'Brien for Monitor

Subject: Insolvency

Headnote

Bankruptcy and insolvency --- Companies' Creditors Arrangement Act — Initial application — Proceedings subject to stay — Contractual rights

Debtor obtained certain materials from licensor pursuant to license agreement — License agreement granted debtor exclusive and perpetual use of materials on royalty-free basis subject to certain conditions — Agreement was not assignable on stand-alone basis but could be assigned in context of major changes in ownership — Licensor was entitled to terminate agreement on basis of insolvency of debtor — Debtor successfully applied for protection under Companies' Creditors Arrangement Act ("CCAA") — Licensor unsuccessfully tried to terminate license agreement — All of debtor's assets were sold to proposed assignee — License agreement was not listed among debtor's assets but assignee wished to assume it — Debtor brought motion for order permanently staying licensor's right of termination and authorizing assignment of license agreement to proposed assignee — Motion dismissed — Court had authority to grant requested relief but only when doing so was important to reorganization process — Such relief had only been granted when sale of debtor's assets could not otherwise proceed — Underlying considerations included purpose and spirit of CCAA proceedings and effect on parties' contractual rights — In this case, asset sale had proceeded without regard to whether agreement would be assigned or not and without notice to licensor — Requested relief would currently have no impact on CCAA proceedings — Another factor was proposed assignee's decision not to assume companion agreement that debtor had with licensor — Granting requested relief at this point would amount to unfair interference with licensor's contractual rights.

Table of Authorities

Cases considered by *H.J Wilton-Siegel J.*:

Playdium Entertainment Corp., Re (2001), [2001] O.T.C. 828, 2001 CarswellOnt 4109, 31 C.B.R. (4th) 309 (Ont. S.C.J. [Commercial List]) — followed

Woodward's Ltd., Re (1993), 17 C.B.R. (3d) 236, 79 B.C.L.R. (2d) 257, 1993 CarswellBC 530 (B.C. S.C.) — followed

Statutes considered:

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

s. 11(4) — referred to

s. 11(4)(c) — considered

Rules considered:

Rules of Civil Procedure, R.R.O. 1990, Reg. 194
R. 57.01(6) — referred to

MOTION by debtor for order permanently staying licensor's right to terminate license agreement and authorizing assignment of license agreement to proposed assignee.

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

1 On this motion, the applicants, Nexient Learning Inc. and Nexient Learning Canada Inc. (collectively, "Nexient") and Global Knowledge Network (Canada) Inc. ("Global Knowledge"), seek an order authorizing the assignment of a contract from Nexient to Global Knowledge on terms that would permanently stay the right of the other party to the contract, ESI International Inc. ("ESI"), to exercise rights of termination that arose as a result of the insolvency of Nexient. ESI is the respondent on the motion, which is brought under the *Companies' Creditors Arrangement Act*, R.S.C. 1985, c. C-36 (the "CCAA") as a result of Nexient's earlier filing for protection under that statutue.

Background

The Parties

2 Nexient Learning Inc. and Nexient Learning Canada Inc. are corporations incorporated under the laws of Canada.

3 Global Knowledge is a corporation incorporated under the laws of Ontario carrying on business across Canada.

4 ESI is a United States corporation having its head office in Arlington, Virginia.

5 Nexient was the largest provider of corporate training and consulting in Canada. It had three business lines, which had roughly equal revenue in 2008: (1) information technology ("IT"); (2) business process improvements ("BPI"); and (3) leadership business solutions. The BPI line of business was principally comprised of three subdivisions — business analysis ("BA"), project management ("PM") and IT Infrastructure Library Training.

6 The curriculum and course materials offered by Nexient in respect of its PM programmes were licenced to Nexient by ESI pursuant to an agreement dated March 29, 2004, as extended by a first amendment dated January 16, 2006 (collectively, the "PM Agreement"). The PM Agreement granted Nexient an exclusive licence to offer the ESI PM course materials in Canada in return for royalty payments. The PM Agreement expires on December 31, 2009.

7 Similarly, the curriculum and course materials offered by Nexient in respect of its BA programmes were licenced to Nexient by ESI pursuant to an agreement dated January 16, 2006 ("BA Agreement"). The BA Agreement was executed

in connection with a transaction pursuant to which ESI received the rights to BA materials from a predecessor of Nexient in return for payment of $2.5 million and delivery of the BA Agreement to the Nexient predecessor. The BA Agreement provided for a perpetual, exclusive royalty-free licence to use such BA materials in Canada.

8 ESI is a significant participant in the market for project management, business analysis, sourcing management training and business skills training. It offers classroom, on-site, e-training and professional services. To deliver its services, ESI typically enters into distributorship arrangements with distributors in countries around the world, which it describes as "strategic partnering arrangements". In Canada, ESI considers Nexient to be its "strategic partner". That arrangement is defined by the PM Agreement, the BA Agreement and, according to ESI, oral understandings and a course of dealings between ESI and Nexient that collectively constitute an "umbrella" agreement.

9 Global Knowledge Training LLC, a United States corporation ("Global Knowledge U.S."), is the parent corporation of Global Knowledge. Together with its affiliates, Global Knowledge U.S. is one of ESI's largest competitors.

Relevant Provisions Of The BA Agreement

10 Despite the grant of a perpetual licence in section 2.1, the BA Agreement provides for three "trigger" events giving rise to a right to terminate the contract. Of the three termination events, the following two are relevant:

> 6. Term and Termination
>
> 6.2 Upon written notice to [Nexient], ESI will have the right to terminate this Agreement in the event of any of the following:
>
> .....
>
> 6.2.2 [Nexient] commits a material breach of any provision of this Agreement and such material breach remains uncured for thirty (30) days after receipt of written notification of such material breach, such written notice to include full particulars of the material breach.
>
> 6.2.3 [Nexient] (i) becomes insolvent, (ii) makes an assignment for the benefit of creditors, (iii) files a voluntary petition in bankruptcy, (iv) an involuntary petition in bankruptcy filed against it is not dismissed within ninety (90) days of filing, or (v) if a receiver is appointed for a substantial portion of its assets.

11 Pursuant to section 8.5, the BA Agreement is not assignable by either party except in the event of a merger, acquisition, reorganization, change of control, or sale of all or substantially all of the assets of a party's business.

12 Section 8.7 of the BA Agreement provides that the agreement is governed by the laws of Virginia in the United States. Section 8.8 provides that the federal and state courts within Virginia have the exclusive jurisdiction over any dispute, controversy or claim arising out of or in connection with the BA Agreement or any breach thereof.

Proceedings under the CCAA

13 On June 29, 2009, Nexient was granted protection under the CCAA by this Court. The initial order made on that day was subsequently amended and restated on two occasions, the latest being August 19, 2009 (as so amended and restated, the "Initial Order").

14 On July 8, 2009, the Court approved a stalking horse sales process involving a third party offeror. The sales process was conducted by the monitor RSM Richter Inc. (the "Monitor"). Both ESI and Global Knowledge participated in that process. In this connection, ESI signed a non-disclosure agreement on July 13, 2009 (the "NDA").

15 By letter dated July 24, 2009 (the "Termination Notice"), ESI purported to terminate the BA Agreement effective immediately on the grounds of breaches of sections 6.2.2 and 6.2.3 of the Agreement (the "Insolvency Defaults"). In

respect of section 6.2.2, ESI alleged that the disclosure to potential purchasers of Nexient's assets of the BA Agreement, and of information relating to the BA materials offered by Nexient thereunder, constituted a breach of the confidentiality provisions of the BA Agreement. By the same letter, ESI purported to grant Nexient a temporary licence to continue acting as ESI's distributor in Canada for the BA materials solely to fulfill Nexient's existing obligations. Such licence was expressed to terminate on August 21, 2009.

16 No similar termination notice was sent in respect of the PM Agreement. As noted, the PM Agreement expires on December 31, 2009.

17 It is undisputed that Nexient owes ESI approximately $733,000 on account of royalties for the use of ESI's corporate training materials. ESI says that this amount includes royalties in respect of two BA courses that are not covered by the BA Agreement and are therefore payable in accordance with the "umbrella" agreement that governs the strategic partnership between ESI and Nexient.

18 By letter dated July 28, 2009, counsel for Nexient informed ESI of its client's view that, given the stay of proceedings in the Initial Order, the Termination Notice was of no force or effect.

19 The existence and content of the Termination Notice and the letter of Nexient's legal counsel dated July 28, 2009 were communicated orally to Brian Branson ("Branson"), the chief executive officer of Global Knowledge U.S., by Donna De Winter ("De Winter"), the president of Nexient, some time between July 28 and July 31, 2009. Both documents were sent to Global Knowledge on or about August 25, 2009.

The Sale Transaction

20 Global Knowledge was the successful bidder in the sales process. In connection with the sale transaction, Nexient and Global Knowledge entered into an asset purchase agreement dated August 5, 2009 (the "APA") and a transition and occupation services agreement dated August 17, 2009 (the "Transition Agreement").

21 Under the APA, Global Knowledge agreed to acquire all of Nexient's assets as a going concern pursuant to the terms of the APA (the "Sale Transaction"). As Global Knowledge had not completed its due diligence of Nexient's contracts, the APA provided for a ninety-day period after the closing date (the "Transaction Period") during which, among other things, Global Knowledge could review the contracts to which Nexient was a party and determine whether it wished to take an assignment of any or all of such contracts. The APA also provided that, prior to the closing date, Global Knowledge had the right to designate any or all of the contracts as "Excluded Assets" which would not be assigned at the closing but would instead be dealt with pursuant to the Transition Agreement. At the Closing, Global Knowledge elected to treat all contracts of Nexient (the "Contracts") as "Excluded Assets".

22 Significantly, section 2.7 of APA provided that the purchase price would not be affected by designation of any assets, including any Contracts, as "Excluded Assets":

> **2.7 Purchaser's Rights to Exclude**
>
> Notwithstanding anything to the contrary in this Agreement, the Purchaser may, at its option, exclude any of the Assets, including any Contracts, from the Transaction at any time prior to Closing upon written notice to the Vendors, whereupon such Assets shall be Excluded Assets, provided, however, that there shall be no reduction in the Purchase Price as a result of such exclusion. For greater certainty, the Purchaser may, at its option, submit further and/or revised lists of Excluded Assets at any time prior to Closing.

Accordingly, there was no reduction in the purchase price under the Sale Transaction as a result of the exclusion of the BA Agreement from the assets that were sold and assigned to Global Knowledge at the Closing (as defined below).

23 It was a condition of completion of the Sale Transaction in favour of both parties that a vesting order, in form and substance acceptable to Nexient and Global Knowledge acting reasonably, be obtained vesting in Global Knowledge

all of Nexient's right, title and interest in the Nexient assets, including the Contracts to be assumed, free and clear of all "Claims" (as defined below). As described below, the Sale Order (defined below) addressed the vesting of all Contracts that Nexient might decide to assume at the end of the Transition Period. It did not, however, include a provision that permanently stayed ESI's rights of termination based on the Insolvency Defaults.

24 Under section 4 of the Transition Agreement, Global Knowledge had the right to review the Contracts and was obligated to notify Nexient of the Contracts it wished to assume not less than seven days prior to the end of the Transition Period. Under section 14(ii), Nexient was obligated to assign to Global Knowledge all of Nexient's right, benefit and interest in such Contracts provided all required consents or waivers in respect of the Contracts to be assigned had been obtained. Upon such assignment, section 6 provided that Global Knowledge would assume all obligations and liabilities of Nexient under such Contracts, whether arising prior to or after Closing. The Transition Agreement further provided that, during the Transition Period, Global Knowledge would perform the Contracts on behalf of Nexient.

25 On or about August 17, 2009, subsequent to submitting Global Knowledge's bid and prior to the hearing of this Court to approve the Sale Transaction, Branson spoke to John Elsey ("Elsey"), the president and chief executive officer of ESI, regarding ESI's right to terminate the BA Agreement. ESI continued to assert that it was entitled to terminate the BA Agreement on the grounds of the Insolvency Defaults. Branson advised Elsey that Global Knowledge had a different interpretation of ESI's right to terminate the BA Agreement. As discussed below, it is unclear whether the parties were addressing the same issue in this and other conversations described below regarding the right of ESI to terminate the Agreement. However, nothing turns on this issue. During that conversation, Branson advised Elsey of the proposed closing date of August 21, 2009 for the Sale Transaction.

26 Branson also spoke to De Winter and Scott Williams of Nexient regarding the enforceability of the Termination Notice (in respect of De Winter, it is unclear whether this is a reference to the telephone conversation referred to above or another conversation). Branson says he was also advised by Nexient's counsel that ESI could not terminate the BA Agreement under Canadian bankruptcy law. In addition, Branson says he also spoke to a representative of the Monitor and its legal counsel. He says their view on the enforceability of the Termination Notice was consistent with the view expressed by De Winter.

27 Following this conversation, Elsey wrote a letter to Branson in which he reiterated that the parties did not agree on the legal effect of the Termination Notice. Elsey went on in that letter to extend the purported interim licence of the BA materials granted in the Termination Notice to September 30, 2009 in view of future discussions concerning possible future collaboration between ESI and Global Knowledge scheduled for the week of September 7, 2009.

Court Approval Of The Sale Transaction

28 The Sale Transaction, together with the APA and the Transition Agreement, was approved by the Court on August 19, 2009 pursuant to the sale approval and vesting order of that date (the "Sale Order"). ESI did not file an appearance in the CCAA proceedings of Nexient. Nexient did not give notice of the Court hearing to ESI. Therefore, ESI did not receive notice of the Court hearing on August 19, 2009 nor did it receive copies of the APA or the Transition Agreement at that time. It did not attend the hearing to approve the Sale Transaction and therefore did not oppose the Order.

29 The Sale Order provided that, upon delivery of the "First Monitor's Certificate" at the time of Closing, the Nexient assets other than the Contracts would vest in Global Knowledge free and clear of any "Claims". Similarly, the Sale Order provided that, upon delivery of the "Second Monitor's Certificate" at the end of the Transition Period, the Contracts to be assigned to Global Knowledge would vest free and clear of any "Claims".

30 "Claims" is defined in the Sale Order to be all security interests, charges or other financial or monetary claims of every nature or kind. "Claims" do not, however, include any rights of termination of the BA Agreement in favour of ESI based on the Insolvency Defaults. Global Knowledge does not dispute this interpretation. Accordingly, it has brought

this proceeding to seek an order directed against ESI permanently staying ESI's rights to terminate the BA Agreement on such basis after the proposed assignment to Global Knowledge.

31 The Sale Transaction closed on August 21, 2009 (the "Closing"). Global Knowledge paid the full purchase price for the Nexient assets at that time. At the same time, the Monitor delivered the First Monitor's Certificate thereby transferring the assets to Global Knowledge free of all Claims.

32 At the time of the Sale Order, the stay under the Initial Order was also extended until the end of the Transition Period. The stay and the Transaction Period were further extended until the hearing of this motion and, at such hearing, were further extended until two days after the release of this Endorsement.

33 Nexient does not intend to file a plan of arrangement under the CCAA. As a result of the completion of the Sale Transaction, it no longer has any operations and all employees as of November 1, 2009 were assumed by Global Knowledge on that date. Upon the lifting of the stay at the end of the Transition Period, it is understood that Nexient intends to make an assignment in bankruptcy.

Events Subsequent To The Closing

34 At the time that Global Knowledge and Nexient entered into the APA, Global Knowledge marketed a few BA courses in Canada, although it says its courses approached the subject-matter in a different manner from ESI's BA courses. Global Knowledge did not offer PM courses in Canada. However, it had access to PM materials from Global Knowledge U.S. that it believed it could readily adapt for the Canadian market.

35 According to De Winter, Nexient did not regard Global Knowledge as a competitor in Canada in the BA and PM product lines at that time. By acquiring the Nexient assets including the BA Agreement, however, Global Knowledge became, in effect, a new competitor in the Canadian market for BA and PM products. At the same time, as described below, ESI, which had previously marketed its products through its strategic arrangement with Nexient, also decided to enter the Canadian market in its own right.

36 Although it had not yet determined to reject the PM Agreement, on or about September 4, 2009, Global Knowledge also commenced discussions with McMaster University regarding recognition of its training facilities and eventual accreditation of its proposed PM courses. The BA and PM courses of ESI offered by Nexient were already accredited by McMaster University.

37 Subsequent to August 21, 2009, ESI and Global Knowledge had discussions regarding their possible future relationship. In a telephone conference on September 11, 2009, attended by representatives of ESI, Global Knowledge and Nexient, Global Knowledge indicated that it did not intend to acquire the PM Agreement.

38 As a result, given the anticipated competition with Global Knowledge, ESI concluded that it would need to find a new strategic partner in Canada or begin delivering its products directly in Canada. It chose to pursue the latter option. In response to ESI commencing direct operations in Canada, Global Knowledge and Nexient commenced the motions described below seeking various orders pertaining to the BA Agreement and the NDA including injunctive relief relating to alleged breaches of these agreements.

39 In early November 2009 Global Knowledge formally advised Nexient pursuant to the Transition Agreement that it proposed to take an assignment of the BA Agreement and the NDA but did not propose to take an assignment of the PM Agreement. Its notice was unconditional — that is, it did not make such assignment conditional on receiving the requested relief in this proceeding.

40 ESI opposes the assignment of the BA Agreement to Global Knowledge on the basis sought by Global Knowledge, which would permanently stay the exercise of any termination rights of ESI based on the Insolvency Defaults.

Procedural Matters

Motions Brought By The Parties

41 Nexient commenced this motion on October 30, 2009. The notice of motion seeks a declaration that the BA Agreement and the PM Agreement remain in force and are both assignable to Global Knowledge, and an order restraining ESI from interfering with Nexient's rights under the BA Agreement and PM Agreement and from carrying on BA and PM training programmes in Canada.

42 On November 3, 2009, Global Knowledge served its own notice of motion seeking the same relief. In addition, Global Knowledge seeks a declaration that the NDA is assignable to it, an order restraining ESI from breaching certain covenants in the NDA that Global Knowledge alleges have been breached relating to ESI's commencement of direct operations in Canada since September 21, 2009, and ancillary relief related to such order.

43 ESI responded by a notice of cross-motion dated November 17, 2009 seeking an order staying or dismissing the Nexient and Global Knowledge motions to the extent the relief sought (1) relates to contracts that have not been assigned to Global Knowledge; (2) does not benefit the Nexient estate; and (3) relates to contracts subject to the exclusive jurisdiction of the courts of Virginia in the United States. ESI takes the position that the BA Agreement is not assignable to Global Knowledge, that the relief sought by Nexient and Global Knowledge benefits only Global Knowledge, and that all matters pertaining to the BA Agreement are within the exclusive jurisdiction of courts in Virginia pursuant to the exclusive jurisdiction clause in that agreement. It therefore also seeks an order staying the motions of Nexient and Global Knowledge insofar as they involve the BA Agreement pending a determination by the appropriate court in Virginia of the disputes, controversies or claims pertaining to the BA Agreement asserted by the parties in their respective motions.

Narrowing Of The Issues For The Court On This Hearing

44 As a result of the following three developments before and at the hearing of this motion, the issues for the Court on this motion have been narrowed considerably.

45 First, as mentioned, Global Knowledge has advised Nexient that it does not intend to assume the PM Agreement. Accordingly, neither Nexient nor Global Knowledge now seeks any relief in respect of the PM Agreement.

46 Second, the parties agreed at the hearing that, on the filing of the Second Monitor's Certificate, the NDA would be assigned to Global Knowledge.

47 Third, the motion of Global Knowledge for injunctive relief in respect of alleged interference with Global Knowledge's rights under the BA Agreement, and in respect of alleged breaches of the NDA, was adjourned to December 21, 2009, by which date it is intended that Global Knowledge shall have commenced a separate application for the relief it seeks against ESI apart from the declaration sought on the present motion.

48 I think it is inappropriate for the Global Knowledge motion respecting injunctive relief to be adjudicated in the Nexient CCAA proceedings. Global Knowledge's claim flows from its rights against ESI under the BA Agreement and the NDA. This claim is entirely a matter between ESI and Global Knowledge. It therefore falls outside the Nexient CCAA proceedings, which will effectively terminate upon the lifting of the stay under the Initial Order at the end of the Transition Period. While Global Knowledge will not formally take an assignment of the BA Agreement and the NDA until such time, I accept that Global Knowledge may have a sufficient interest in these agreements at the present time to obtain injunctive relief, in view of Nexient's obligation under the Sale Agreement to assign them to Global Knowledge. However, to obtain such relief, Global Knowledge must first commence its own proceeding against ESI and move for such interim injunctive relief in that proceeding.

49 Similarly, ESI's request for a stay of the Global Knowledge motion is adjourned to the hearing of the motion on December 21, 2009. At that time, ESI is at liberty to bring any motion in the proceeding to be commenced by Global Knowledge it may choose addressing the jurisdictional issues raised in its cross-motion in the present proceeding.

Issues On This Motion

50 Accordingly, the issues that are addressed on this motion are:

1. Is the BA Agreement assignable to Global Knowledge, on its terms or by order of this Court?

2. If it is, is Global Knowledge entitled to an order in connection with such assignment that permanently stays the exercise of any rights that ESI may have to terminate the BA Agreement based on the Insolvency Defaults?

51 The issue of the assignability of the BA Agreement has two elements — the assignability of the agreement as a matter of interpretation of the contract which, as noted, is governed by the laws of the Virginia, and the authority of the Court to authorize an assignment to Global Knowledge if the contract is not assignable on its terms. In view of the determination below regarding the authority of the Court to authorize an assignment, it is unnecessary to consider the assignabilty of the BA Agreement as a matter of contractual interpretation and I therefore decline to do so.

52 I would note, however, that if I had concluded that Global Knowledge was entitled to the requested relief effectively deleting the Insolvency Defaults, I would also have concluded, for the same reasons, that Global Knowledge was entitled to an order authorizing the assignment of the BA Agreement to the extent it was not otherwise assignable under the laws of Virginia.

Applicable Law

Authority Of The Court To Grant The Requested Relief

53 The Court has authority to authorize an assignment of an agreement to which a debtor under CCAA protection is a party and to permanently stay termination of the agreement by the other party to the contract by reason of either the assignment or any insolvency defaults that arose in the context of the CCAA proceedings: see *Playdium Entertainment Corp., Re*, [2001] O.J. No. 4459 (Ont. S.C.J. [Commercial List]).

54 In *Playdium*, Spence J. grounds that authority in the provisions of section 11(4)(c) of the CCAA and, alternatively, in the inherent jurisdiction of the Court. The reasoning, which I adopt, is set out in paragraphs 32 and 42:

> So it is necessary for the order to have such positive effect if the jurisdiction of the court to grant the order under s. 11(4)(c) is to be exercised in a manner that is both effective and fair. To the extent that the jurisdiction to make the order is not expressed in the CCAA, the approval of the assignment may be said to be an exercise by the court of its inherent jurisdiction. But the inherent jurisdiction being exercised is simply the jurisdiction to grant an order that is necessary for the fair and effective exercise of the jurisdiction given to the court by statute....
>
> Having regard to the overall purpose of the Act to facilitate the compromise of creditors' claims, and thereby allow businesses to continue, and the necessary inference that the s. 11(4) powers are intended to be used to further that purpose, and giving to the Act the liberal interpretation the courts have said that the Act, as remedial legislation should receive for that purpose, the approval of the proposed assignment of the Terrytown Agreement can properly be considered to be within the jurisdiction of the court and a proper exercise of that jurisdiction.

Consideration Of The Applicable Standard In Previous Decisions

55 However, the test that must be satisfied in order to obtain an order authorizing assignment remains unclear after *Playdium*. In that decision, it was clear that the sale of the debtor's assets could not proceed without the requested order. This would seem to suggest that demonstration of that fact was the applicable test.

56 On the other hand, in para. 39, Spence J. quotes with approval a statement of Tysoe J. in *Woodward's Ltd., Re*, [1993] B.C.J. No. 42 (B.C. S.C.) that suggests that it may not be a requirement that the insolvent company would be

unable to complete a proposed reorganization without the exercise of the Court's discretion. Tysoe J. framed the test as requiring a demonstration that the exercise of the Court's discretion be "important to the reorganization process". In my opinion, this is the governing test.

57 In addition, in para. 43 of *Playdium*, Spence J. appears to grant the requested relief after determining that the relief did not subject the third party to an inappropriate imposition or an inappropriate loss of claims having regard to the overall purpose of the CCAA of allowing businesses to continue.

58 Moreover, Spence J. also considered a number of factors in assessing whether the relief was consistent with the purpose and spirit of the CCAA: whether sufficient efforts had been made to obtain the best price such that the debtor was not acting improvidently; whether the proposal takes into consideration the interests of the parties; the efficacy and integrity of the process by which the offers were obtained; and whether there had been unfairness in the working out of the process.

Standard Applied On This Motion

59 It is clear from *Playdium* and *Woodwards* that the authority of the Court to interfere with contractual rights in the context of CCAA proceedings, whether it is founded in section 11(4) of the CCAA or the Court's inherent jurisdiction, must be exercised sparingly. Before exercising the Court's jurisdiction in this manner, the Court should be satisfied that the purpose and spirit of the CCAA proceedings will be furthered by the proposed assignment by analyzing the factors identified by Spence J. and any other factors that address the equity of the proposed assignment. The Court must also be satisfied that the requested relief does not adversely affect the third party's contractual rights beyond what is absolutely required to further the reorganization process and that such interference does not entail an inappropriate imposition upon the third party or an inappropriate loss of claims of the third party.

The Specific Legal Issue Presented On This Motion

60 This motion raises an important issue concerning the extent of the authority of the Court to authorize the assignment of a contract in the face of an objection from the other party to the contract. ESI argues that a Court should not permit a purchaser under a "liquidating CCAA" to "cherry pick" the contracts it wishes to assume.

61 Insofar as the result would be to prevent a debtor subject to CCAA proceedings from selling only profitable business divisions or would prevent a purchaser from deciding which business divisions it wishes to purchase, I do not think ESI's proposition is either correct or practical. The purpose of the CCAA is to further the continuity of the business of the debtor to the extent feasible. It does not, however, mandate the continuity of unprofitable businesses.

62 However, the situation in which a purchaser seeks to assume less than all of the contracts between a debtor and a particular third party with whom the debtor has a continuing or multifaceted arrangement is more problematic. In many instances in which a purchaser wishes to discriminate among contracts with the same third party, the Court will not exercise its authority under the CCAA, or its inherent jurisdiction, to authorize an assignment and/or permanently stay termination rights based on insolvency defaults. In such circumstances, the purchaser must assume all contracts with the third party or none at all.

63 There can be many reasons why it would be inappropriate or unfair to authorize the assignment of less than all of a debtor's contracts with a third party. In many instances, there is an interconnection between such contracts created by express terms of the contracts. Similarly, there may be an operational relationship between the subject-matter of such contracts even if there is no express contractual relationship. Courts are also reluctant to authorize an assignment that would prevent a counterparty from exercising set-off rights in contracts that are not to be assigned. In respect of financial contracts between the same parties, for example, it would be highly inequitable to permit a purchaser to take only "in the money" contracts leaving the counterparty with all of the "out of the money" contracts and only an unsecured claim against the debtor for its gross loss. It would also be inappropriate in many circumstances to permit a selective assignment

of a debtor's contracts if the competitive position of the third party relative to the assignee would be materially and adversely affected, at least to the extent the third party is unable to protect itself against such result.

Analysis and Conclusions

Preliminary Observations

64 Before addressing the issues on this motion, I propose to set out the following observations which inform the conclusions reached below.

65 First, being a perpetual, royalty-free licence, the BA Agreement represents a valuable contract to Nexient except to the extent that ESI is entitled to terminate it. It represents part of the sales proceeds received in an earlier transaction by Nexient for the BA materials developed by a predecessor of Nexient. While there is an issue as to whether the current BA materials are still subject to the BA Agreement, that issue requires a determination of facts that cannot be made in the present proceeding. It must be addressed, if necessary, in another proceeding. For the purposes of this motion, I assume that such materials could be subject to the BA Agreement, which would therefore have significant value in Nexient's hands.

66 Second, Global Knowledge was well aware that ESI's position was that it had the right to terminate the BA Agreement. As a consequence, Global Knowledge was also well aware that ESI would use any means available to it to terminate the BA Agreement after it had been assigned to Global Knowledge if ESI and Global Knowledge were unable to establish a satisfactory working relationship. Global Knowledge did not, however, seek any protections against such action by ESI in either the APA or the Sale Order.

67 In particular, as mentioned, section 4.3 of the Sale Agreement provided that the obligation of the parties to close the Sale Transaction was subject to receipt of a vesting order of this Court satisfactory in form to both parties. However, the Sale Order that was actually sought by Nexient and Global Knowledge, and was granted by the Court, did not address deletion of any of ESI's termination rights based on the Insolvency Defaults.

68 There is no explanation in the record for the failure of the Sale Order to address this matter notwithstanding the fact that, as a matter of law as set out above, there could have been no misunderstanding as to the legal requirement for terms in the Sale Order imposing a permanent stay if, at the time of the sale approval hearing, Global Knowledge in fact intended to receive a transfer of the BA Agreement on such terms. As both parties were represented by experienced legal counsel, I assume the form of the Sale Order reflected a conscious decision on the part of Global Knowledge not to address this issue explicitly at the time of the hearing.

69 Third, while Nexient and Global Knowledge allege that their intention at the time of the hearing was that the BA Agreement was to be assigned on the basis that ESI's rights to terminate it on the basis of the Insolvency Defaults would be permanently stayed, there is no evidence of such intention in the record apart from Branson's bald statements to this effect in his affidavit, which is insufficient.

70 Moreover, the evidence of Branson exhibits a lack of precision regarding his understanding of the applicable law and Global Knowledge's intentions. In both his affidavit and the transcript of his cross-examination, Branson refers to his understanding that the stay in the Initial Order prevented ESI from terminating its contractual relationship with Nexient without an order of the Court. In his affidavit, he added that he understood that, as a consequence, to the extent that contracts did not contain restrictions on assignment, they could be assigned to the successful bidder and would remain in force and effect after the assignment. This implies that he thought the Initial Order would also prevent ESI from terminating its contractual relationship with Global Knowledge, as the assignee of the Nexient contracts, without a further order of the Court.

71 As *Playdium* demonstrates, there are two different issues involved here. The stay in the Initial Order did prevent ESI from terminating the BA Agreement under Ontario Law as long as the CCAA proceedings are continuing. Indeed,

because delivery of the Termination Notice contravened the Initial Order, I think the Termination Notice must be regarded as totally ineffective under Ontario Law with the result that ESI could not rely on it subsequently if ESI became entitled to terminate the BA Agreement after the assignment to Global Knowledge or otherwise.

72 The stay did not, however, by itself have the consequence of staying enforcement of any right of ESI to terminate the BA Agreement based on the Insolvency Defaults after it had been assigned to Global Knowledge. That is, of course, the reason for the present motion. Any such order would constitute, in effect, a re-writing of the BA Agreement to remove ESI's rights. As *Playdium*illustrates, a further order of the Court would be required to permanently stay ESI's rights to terminate the BA Agreement based on the Insolvency Defaults. Not only did Global Knowledge not seek such an order as mentioned above, it also did not require Nexient to give ESI formal notice of the Court hearing to approve the Sale Transaction.

73 In the absence of such notice, I do not think any order of this Court to permanently stay ESI's rights to terminate the BA Agreement based on the Insolvency Defaults would have been binding on ESI, even though ESI had not filed an appearance in the CCAA Proceedings and had been orally advised as to the date of the hearing. Nexient and Global Knowledge therefore cannot argue that ESI's failure to oppose the Sale Order at the hearing constituted "lying in the weeds," which disentitles ESI to sympathetic consideration on this motion. Moreover, in addition to the fact that it is not established on the record that either Nexient or Global Knowledge specifically advised ESI of an intention to seek an order permanently staying ESI's termination rights based on the Insolvency Defaults, the Sale Order does not have that effect in any event, as mentioned above. There was, therefore, nothing for ESI to oppose on this issue even if it had appeared at the approval hearing.

74 Fourth, given the structure of the Sale Transaction, there is no impact on the Sale Transaction of an exclusion of the BA Agreement from the Contracts assigned to Global Knowledge. Global Knowledge has already paid the purchase price under the Sale Agreement. The effect of section 2.7 of the APA is that there will no adjustment to the purchase price if, as transpired, Global Knowledge was unable to reach agreement with ESI on acceptable terms for the assignment of the BA Agreement. There is similarly no material impact on Nexient's customers - the BA product will be delivered in Canada by either Global Knowledge or ESI depending upon the outcome of this litigation. As such, at the present time, the requested relief will have no impact on the CCAA proceedings, or on the distributions realized by Nexient's creditors under these proceedings.

75 Fifth, although there is no contractual connection between the subject matter of the PM Agreement and the BA Agreement, there is a significant operational relationship between the PM and BA product lines. They comprise two of the three product lines of Nexient's BPI division. Both products are licenced by Nexient from ESI. In many instances, both products are marketed to the same customers. In addition, Nexient's facilitators provide educational services in respect of both products. There may also be certain economies of scale associated with offering both products. In her cross-examination, De Winter summarized the situation succinctly in stating that "one product line can't operate without the other".

76 There is also a significant business relationship between ESI and Nexient. Nexient was the Canadian distributor through which ESI marketed and sold its BA and PM products. At the present time, Nexient owes ESI in excess of $733,000 in respect of royalties payable under the PM Agreement. ESI says that this amount also includes royalties for two BA courses that are not governed by the BA Agreement. It also asserts that the BA materials described in the BA Agreement no longer are included in the current BA materials as a result of subsequent revisions. There are, therefore, several issues relating to the provision of the BA materials currently distributed by Nexient that would remain to be resolved if the BA Agreement were transferred to Global Knowledge.

77 Sixth, in his affidavit, Branson gave three reasons for Global Knowledge's decision not to assume the PM Agreement: (1) the PM Agreement terminates on December 31, 2009; (2) Global Knowledge would have to assume the amounts outstanding under the PM Agreement; and (3) Global Knowledge has access to similar course materials for

which it would pay lower or no royalties. Although Branson says that the outstanding liability under the PM Agreement was not the principal factor in Global Knowledge's decision, it would appear that it was an important consideration.

78 There is no suggestion that Global Knowledge was unaware of the amount outstanding under the PM Agreement at a time of signing the APA or at the time of Closing. Although Global Knowledge did not decide against taking an assignment of the PM Agreement until later, it appears that, from the time of signing the APA if not earlier, Global Knowledge proceeded on the basis that it was not prepared to assume the PM Agreement unless ESI agreed to significantly different terms, including a reduction in the amount owing under the agreement and a reduction in the royalties payable for the PM materials. If it had intended instead to assume the PM Agreement with its outstanding liability, or to keep open that possibility, Global Knowledge could simply have provided for a reduction in the purchase price in such amount in the event it assumed the PM Agreement.

79 This is significant because, as discussed below, the issue before the Court would have been considerably different, and simpler, if Nexient had proposed to assign, and Global Knowledge had proposed to assume, both the PM Agreement and the BA Agreement as they stand. In such event, the question of whether a purchaser could "cherry pick" contracts of a debtor with the same third party on a sale of the debtor's assets would not have arisen. Moreover, given the expiry date of the PM Agreement and Global Knowledge's need to adapt the PM courses to which it had access, it would have been able to implement essentially the same business plan as it is currently proposing to implement without the need for any Court order provided its interpretation of the conflict provisions in the BA Agreement is correct. In such circumstances, the principal effect of assuming the PM Agreement would have been the assumption of the liability of approximately $733,000 owed to ESI, which Global Knowledge alleges was not the principal factor in its decision to reject the PM Agreement.

80 Seventh, Global Knowledge seeks relief that is related solely to the BA Agreement. It treats the BA Agreement and the PM Agreement as completely unrelated to each other. This treatment is not entirely unjustified in view of the wording of these agreements. Section 6.6.1 of the BA Agreement does not expressly refer to the provision of services or products that compete with PM products delivered under the PM Agreement. Whether this interpretation is affected by the course of dealing or the alleged "umbrella" agreement between the parties is not an issue that can be addressed on this motion.

81 However, given that, on this motion, Global Knowledge and Nexient seek relief that requires the exercise of the Court's discretion under section 11(4) of the CCAA or pursuant to its inherent jurisdiction, I think the contractual arrangements between the parties, while important, are not the only factors to be considered by the Court. Instead, the Court should look to the entirety of the arrangement between ESI and Nexient and assess (1) the extent of the adverse impact on ESI of the order sought by Nexient and Global Knowledge and (2) whether there are any alternatives to the proposed relief that achieve the same result with less encroachment on ESI's rights.

Analysis and Conclusions

82 The applicants' request for relief is denied for the following three reasons.

83 First, because of the structure of the Sale Transaction, the requested relief will not further the CCAA proceedings and will have no impact on Nexient or its stakeholders. The Sale Transaction has been completed and cannot be unwound. At the present time, the only impact of the proposed relief is to adversely affect ESI's rights to terminate the BA Agreement after the proposed assignment to Global Knowledge.

84 The evidence is, therefore, insufficient to satisfy the test noted by Spence J., and adopted above, that the requested order be important to the reorganization process. The time to request such relief was either at the time of negotiation of the Sale Agreement or at the time of the Sale Order. Given the terms of the Sale Transaction - in particular, the fact that the purchase price has been paid and is not subject to adjustment in respect of any exclusion of assets - it is impossible to demonstrate that the requested order is important to the reorganization after closing of the Sale Transaction. The proposed relief also cannot satisfy the requirement that it adversely affect ESI's contractual rights only to the extent

necessary to further the reorganization process. Accordingly, it also cannot be said that such interference with ESI's contractual rights does not entail an inappropriate imposition upon ESI.

85 Second, there is no evidence that Nexient and Global Knowledge intended at the time of entering into the Sale Transaction, or at the time of the approval hearing, to assign the BA Agreement to Global Knowledge on the basis of a permanent stay preventing ESI from terminating the BA Agreement based on the Insolvency Defaults. There is, therefore, no basis for an order rectifying the Sale Order to include such provisions at the present time. In reaching this conclusion, the following considerations are relevant.

86 The structure of the Sale Transaction contradicts the existence of the alleged intention. At Closing, Global Knowledge elected to treat all Contracts as "Excluded Assets". Consequently, given the structure of the Sale Transaction, Global Knowledge assumed the risk that it might be unable to reach an acceptable accommodation with ESI with whatever consequences that entailed. The evidence before the Court does not explain the thinking behind Global Knowledge's decision to take this calculated risk but the actual reason is irrelevant to the determination of this motion. It is impossible to conclude that the parties intended at the time of Closing to transfer the BA Agreement on the basis of a permanent stay given that Global Knowledge had not yet reached a conclusion as to whether it even wished to take the BA Agreement. The most that can be said is that the parties may have had an intention to transfer the BA Agreement on the basis of a permanent stay *if* Global Knowledge decided later to take an assignment. This does not constitute an intention at the time of the Court approval hearing. It also begs the question of why, even on such a conditional intention, the parties did not seek appropriate conditional relief at the time of the hearing on the Sale Order.

87 More generally, the evidence suggests that, at the time of Closing, Global Knowledge had not decided between two options — to attempt to renegotiate the BA Agreement and the PM Agreement on favorable terms, including the financial arrangements, or to assume the BA Agreement only and seek a Court order permanently staying ESI's rights of termination based on the Insolvency Defaults. Global Knowledge pursued the first option until the September 11, 2009 telephone conference, after which it appears to have decided to pursue the second. On this scenario, Global Knowledge cannot say that, at the time of Closing or of the Court approval hearing, it intended to take an assignment of the BA Agreement on the basis of a permanent stay.

88 In any event, to obtain rectification, Nexient and Global Knowledge must demonstrate that ESI shared the alleged intention, or alleged understanding, or that ESI acquiesced in the alleged intention or understanding. They cannot do so on the evidence before the Court.

89 It is impossible to infer from the relative significance of the BA Agreement to Nexient that all the parties must have understood that Global Knowledge would be receiving an assignment of the BA Agreement free of any risk of termination by ESI. The BA product line represented less than one-third of the total revenues of Nexient. There is no evidence in the record of its relative contribution to profit. The only evidence are unsupported statements in Branson's affidavit to the effect that the BA Agreement was a "highly material contract" in Global Knowledge's consideration of its bid for the Nexient assets. There is nothing in the description of the conversation between Elsey and Branson on or about August 17, 2009 or otherwise in the record to support Branson's statement.

90 Global Knowledge submits that this intention should be inferred from the fact that the Sale Transaction was on a "going-concern" basis. Such an inference might be reasonable if Global Knowledge was, in fact, purchasing all of the Nexient assets on a "going-concern" basis. Its failure to take all of the Contracts, including the PM Agreement, however, excludes such an inference in the present circumstances.

91 Third, Global Knowledge has failed to demonstrate circumstances that would justify the exercise of the Court's discretion to order a permanent stay against ESI in respect of its rights of termination based on the Insolvency Defaults in the BA Agreement given Global Knowledge's decision not to take an assignment of the PM Agreement. In reaching this conclusion, I have taken the following factors into consideration.

92 I acknowledge that there are factors weighing in favour of authorizing an assignment of the BA Agreement on the requested terms of a permanent stay against ESI. As mentioned, the BA Agreement appears to constitute a valuable asset of Nexient. It is in the interests of Nexient's creditors that value be received for such asset by way of an assignment. In addition, the sale price for the Nexient assets, including the BA Agreement, was arrived at in a sales process previously approved by this Court. There is no suggestion that the process lacked integrity, that the price for the assets did not represent fair market value or that it was an improvident sale.

93 However, by taking an assignment of the BA Agreement but not the PM Agreement, ESI is adversely affected in two respects.

94 First, in any negotiations between Global Knowledge and ESI relating to issues under the BA Agreement, including the two issues relating to the BA materials described above and the extent to which, if at all, the conflict provisions of section 6.2.1 of the BA Agreement prevent the marketing of Global Knowledge's PM products, ESI's bargaining position has been weakened by the exclusion of its claim for royalties owing under the PM Agreement.

95 Second, and more generally, ESI will be competitively disadvantaged in the Canadian marketplace if it is unable to deliver both its PM products and its BA products either directly or through a new "strategic partner". As discussed above, the evidence in the record indicates that there is a significant benefit to having a common entity market both BA products and PM products. This was reflected in Nexient's BPI business line and in Global Knowledge's own business plan, both of which involved marketing both product lines together.

96 This raises the issue of whether the Court should refuse to exercise its discretion to order a permanent stay of ESI's rights to terminate the BA Agreement based on the Insolvency Defaults in the circumstances in which Global Knowledge does not intend to take an assignment of the PM Agreement. In my view, such order should not be granted for three reasons.

97 First, as mentioned, in the present circumstances, the purposes of the CCAA will not be furthered by the proposed relief. Given the structure of the Sale Transaction, it is unnecessary to grant the requested relief to complete the Sale Transaction at the agreed sale price. Moreover, the effect of such an order would be to destroy the overall relationship between ESI and Nexient. rather than to continue the BPI business line of Nexient in its form prior to the CCAA proceedings.

98 Second, as mentioned, whether intentional or not, Global Knowledge is seeking to use the CCAA proceedings as a means of competitively disadvantaging ESI in Canada. ESI and Global Knowledge are already competitors in the United States. ESI will be competitively disadvantaged in Canada if it can offer only its PM products and not its BA products and Global Knowledge will be correspondingly advantaged. The Court's discretion should not be invoked to competitively disadvantage a licensor to the debtor in favour of a purchaser of the debtor's assets where the licensor has bargained for protection against such event in its contract with the debtor.

99 ESI bargained for the right to ensure that its BA courses and PM courses were marketed by an entity of its own choosing after an insolvency of Nexient through the inclusion of the insolvency termination provisions in the BA Agreement and PM Agreement. I do not think that the Court's authority should be invoked to remove that right as a result of Nexient's CCAA proceedings in the present circumstances where the PM Agreement is not to be assumed by Global Knowledge. ESI cannot expect to improve its competitive position as a result of the CCAA proceedings. Conversely, the Court's discretion should not be invoked in CCAA proceedings to weaken the competitive position of ESI in favour of a competitor.

100 Third, the discretion of the Court should not be invoked after failed negotiations between the purchaser and the third party respecting the feasibility of an on-going relationship. As mentioned above, Global Knowledge excluded the BA Agreement and the PM Agreement at Closing pending not only a review of the agreements themselves but, more importantly, pending the outcome of negotiations between Global Knowledge and ESI regarding the possibility of a

workable relationship. Among other things, such a relationship required a renegotiation of the financial terms of the PM Agreement to the benefit of Global Knowledge that ESI was not prepared to accept. Those negotiations were conducted on the basis that the Sale Order did not include any terms providing for a permanent stay of ESI's termination rights in respect of the BA Agreement. In entering into the APA and closing on an unconditional basis, Global Knowledge accepted the risk that such negotiations would prove unsuccessful. It is not appropriate for the Court to exercise its discretion at this stage to re-write the terms of the BA Agreement to the detriment of ESI in order to adjust the financial benefits of the Sale Transition in favour of Global Knowledge. To do so would be to change the relative bargaining positions of the parties after their negotiations had terminated.

Conclusion

101 Based on the foregoing, I conclude that, while the Court has authority to authorize an assignment of the BA Agreement to Global Knowledge notwithstanding any provision to the contrary in that agreement, it should not exercise its discretion to authorize the proposed assignment on the basis requested by Global Knowledge, which involves the issue of a permanent stay against the exercise of any rights of ESI to terminate the BA Agreement based on the Insolvency Defaults.

Costs

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

Motion dismissed.

End of Document

TAB 9

2015 BCSC 1204
British Columbia Supreme Court

Veris Gold Corp., Re

2015 CarswellBC 1949, 2015 BCSC 1204, [2015] B.C.W.L.D. 4800, 256 A.C.W.S. (3d) 765, 26 C.B.R. (6th) 310

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

In the Matter of the Canada Business Corporations Act, R.S.C. 1985, c. C-44

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

In the Matter of Veris Gold Corp., Queenstake Resources Ltd., Ketza River Holdings, and Veris Gold USA, Inc., Petitioners

Fitzpatrick J.

Heard: May 28, 2015
Judgment: July 10, 2015
Docket: Vancouver S144431

Counsel: J. Sandrelli, T. Jeffries for Monitor, Ernst & Young Inc.
D. Vu, for Deutsche Bank A.G.
C. Ramsay, S. Irving, K. Mak for Moelis & Company
K. Jackson, D. Toigo for Whitebox Advisors LLC, WBox 2014-1 Ltd.
R. Morse, N. Vaartunou (A/S) for Attorney General of Nevada
C. Ramsay, K. Mak for Nevada Cement
C. Brousson, J. Bradshaw (A/S) for NV Energy
J. Porter for Government of Yukon
K. Siddall for AIG
S. Ross for Linde LLC

Subject: Insolvency; International

Headnote

Bankruptcy and insolvency --- Companies' Creditors Arrangement Act — Arrangements — Approval by court — "Fair and reasonable"

Assets of petitioner companies were gold mine in USA and mining properties in Canada — Initial order was granted in June 2014 due to steps taken by major secured creditor, DB to collect debt of approximately US$90 billion — Matters were stabilized, and in October 2014 court approved interim financing from WB in amount of US$12 million — Detailed sale and solicitation process was approved, but no qualified bids were received — Eventually petitioner entered into asset sale agreement with WBVG, which was wholly owned by WB — Monitor brought application to complete asset sale agreement — Application granted — Factors set out in s. 36(3) of Companies' Creditors Arrangement Act supported granting order — Process leading to transaction were fair and reasonable — Sale was best outcome for operational stakeholders — WBVG was to be assigned contracts as this would facilitate continuation of operations — Due to exigent and extraordinary circumstances, assignments were approved subject to US court being satisfied with notification to and service on counterparties to assigned contracts who did not received direct notice of application to approve sale.

Table of Authorities

Cases considered by *Fitzpatrick J.*:

Barafield Realty Ltd. v. Just Energy (B.C.) Limited Partnership (2014), 2014 BCSC 945, 2014 CarswellBC 1485, 13 C.B.R. (6th) 163 (B.C. S.C.) — referred to

Canwest Publishing Inc./Publications Canwest Inc., Re (2010), 2010 ONSC 2870, 2010 CarswellOnt 3509, 68 C.B.R. (5th) 233 (Ont. S.C.J. [Commercial List]) — referred to

Nexient Learning Inc., Re (2009), 2009 CarswellOnt 8071, 62 C.B.R. (5th) 248 (Ont. S.C.J.) — considered

PCAS Patient Care Automation Services Inc., Re (2012), 2012 ONSC 3367, 2012 CarswellOnt 7248, 91 C.B.R. (5th) 285 (Ont. S.C.J. [Commercial List]) — referred to

Playdium Entertainment Corp., Re (2001), 2001 CarswellOnt 3893, 18 B.L.R. (3d) 298, 31 C.B.R. (4th) 302 (Ont. S.C.J. [Commercial List]) — referred to

Playdium Entertainment Corp., Re (2001), 2001 CarswellOnt 4109, 31 C.B.R. (4th) 309, [2001] O.T.C. 828 (Ont. S.C.J. [Commercial List]) — referred to

Royal Bank v. Soundair Corp. (1991), 7 C.B.R. (3d) 1, 83 D.L.R. (4th) 76, 46 O.A.C. 321, 4 O.R. (3d) 1, 1991 CarswellOnt 205 (Ont. C.A.) — followed

TBS Acquireco Inc., Re (2013), 2013 ONSC 4663, 2013 CarswellOnt 9481, 3 C.B.R. (6th) 261 (Ont. S.C.J. [Commercial List]) — considered

Ted Leroy Trucking Ltd., Re (2010), 2010 SCC 60, 2010 CarswellBC 3419, 2010 CarswellBC 3420, 12 B.C.L.R. (5th) 1, (sub nom. *Century Services Inc. v. A.G. of Canada)* 2011 D.T.C. 5006 (Eng.), (sub nom. *Century Services Inc. v. A.G. of Canada)* 2011 G.T.C. 2006 (Eng.), [2011] 2 W.W.R. 383, 72 C.B.R. (5th) 170, 409 N.R. 201, (sub nom. *Ted LeRoy Trucking Ltd., Re)* 326 D.L.R. (4th) 577, (sub nom. *Century Services Inc. v. Canada (A.G.))* [2010] 3 S.C.R. 379, [2010] G.S.T.C. 186, (sub nom. *Leroy (Ted) Trucking Ltd., Re)* 296 B.C.A.C. 1, (sub nom. *Leroy (Ted) Trucking Ltd., Re)* 503 W.A.C. 1 (S.C.C.) — considered

Veris Gold Corp., Re (2015), 2015 BCSC 399, 2015 CarswellBC 662, 23 C.B.R. (6th) 321 (B.C. S.C.) — referred to

White Birch Paper Holding Co., Re (2010), 2010 QCCS 4915, 2010 CarswellQue 10954, 72 C.B.R. (5th) 49 (C.S. Que.) — considered

White Birch Paper Holding Co., Re (2010), 2010 QCCA 1950, 2010 CarswellQue 11534, 72 C.B.R. (5th) 74 (C.A. Que.) — referred to

Woodward's Ltd., Re (1993), 17 C.B.R. (3d) 236, 79 B.C.L.R. (2d) 257, 1993 CarswellBC 530 (B.C. S.C.) — referred to

Statutes considered:

Bankruptcy Code, 11 U.S.C.
Generally — referred to

Chapter 15 — referred to

s. 365(b)(1) — referred to

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

s. 11.3 [en. 1997, c. 12, s. 124] — considered

s. 11.3(1) [en. 2005, c. 47, s. 128] — considered

s. 11.3(2) [en. 2005, c. 47, s. 128] — considered

s. 11.3(3) — considered

s. 11.3(4) — considered

s. 11.3(5) [en. 2005, c. 47, s. 128] — considered

s. 36 — considered

s. 36(3) — considered

APPLICATION by monitor for order approving and completing asset sale agreement.

***Fitzpatrick J.*:**

Introduction

1 This is a proceeding pursuant to the *Companies' Creditors Arrangement Act*, R.S.C. 1985, c. C-36 (the "*CCAA*"). The assets of the petitioner companies (collectively, "Veris Gold") principally comprise a gold mine in the State of Nevada, United States of America and mining properties in Yukon, Canada.

2 There has been no shortage of effort in these proceedings to restructure the considerable debt or monetize the assets of Veris Gold for the benefit of the stakeholders. However, in the face of considerable operational setbacks and disappointing refinancing and sale results, those stakeholders now face two stark options: (i) allow the interim lender to deal with the assets in a receivership or liquidation scenario; or (ii) allow an orderly transfer of the assets to that interim lender by way of a credit bid which would allow operations in the U.S. to continue.

3 The court-appointed monitor, Ernst & Young Inc., (the "Monitor") now applies to complete the sale to a new entity created by the interim lender, which is said to provide the best result achievable in less than desirable circumstances.

Background Facts

4 Much of the history of these proceedings was set out in my reasons for judgment issued earlier this year: *Veris Gold Corp., Re*, 2015 BCSC 399 (B.C. S.C.) . For the purposes of this application, I will summarize that history as follows.

5 On June 9, 2014, this Court granted an initial order. This filing was necessary in light of the imminent steps that were to be taken by Veris Gold's major secured creditor, Deutsche Bank A.G. ("DB") to collect its debt of approximately US$90 million.

6 The Canadian filing was immediately followed by the Monitor commencing proceedings in Nevada pursuant to Chapter 15 of the *United States Bankruptcy Code*, 11 U.S.C. §§ 101-1532 (the "*Bankruptcy Code*").

7 Arising from orders granted in both the Canadian and Nevada proceedings and the agreements reached between Veris Gold and DB, matters were stabilized. Those orders and agreements allowed Veris Gold to continue its efforts to restructure its debt and equity with the assistance of Raymond James & Associates. In addition, firm milestone dates were put in place to conclude any refinancing and also to commence a sales process if those refinancing efforts were not successful.

8 In October 2014, this Court approved interim financing to be obtained from WBox 2014-1 Ltd. ("WBox") in the amount of US $12 million.

9 On November 18, 2014, this Court approved a detailed sale and solicitation process to be conducted by Moelis and Company ("Moelis"), again with firm deadlines for such matters as receipt of qualified bids. Although certain of the deadlines under the sales process were extended, no qualified bids were received by the extended bid deadline, January 30, 2015.

10 Following these disappointing sale results, the Monitor engaged in discussions with Veris Gold and the two stakeholders who appeared to have the only economic interest remaining in the assets, being DB and WBox. What was critical at this time was allowing Veris Gold to continue to operate in the ordinary course while these stakeholders considered their next steps.

11 In mid-February 2015, DB issued various notices of default under its security and the agreements reached earlier with Veris Gold. This also resulted in an immediate default under the interim financing agreements between Veris Gold and WBox. With a view to securing greater oversight over the continued operations of Veris Gold, DB later applied for and was granted an order expanding the powers of the Monitor on February 23, 2015. That order was later recognized by the U.S. court in the Chapter 15 proceedings on March 2, 2015.

12 By late March 2015, both DB and WBox were continuing to consider their options, including the possibility of making a credit bid for the assets. WBox conducted due diligence of the assets toward that possibility. The Monitor reported at that time that, absent a credit bid from DB, a credit bid from WBox was the only viable alternative.

13 Accordingly, on March 30, 2015, this Court granted an order extending the stay of proceedings to April 7, 2015 to enable completion of discussions in relation to a credit bid transaction whereby certain of Veris Gold's assets would be transferred to a nominee of WBox.

14 On April 2, 2015, Veris Gold suffered yet another operational setback when a fire occurred at the processing plant, causing an estimated shutdown of one week. The already tenuous cash problems were therefore exacerbated by the deferral of revenue of approximately US$4 million as a result of the shutdown. The timing of this difficulty was unfortunate, in that by this time, the Monitor had negotiated an agreement in principle with WBox for the purchase of the assets and an increase in the interim funding to allow operations to continue to the closing date.

15 Not surprisingly, the fire and ensuing difficulties caused WBox to delay any credit bid and the provision of further financing while it considered, among other things, the impact on the cash requirements of continuing operations. In addition, in light of what the Monitor described as the "mounting challenges", the Monitor and WBox moved to a consideration of liquidation scenarios. Preliminary work on various shutdown options, including care and maintenance, indicated that significant monies would have to be expended even before the assets could be transferred on an orderly basis to environmental regulators.

16 On April 7, 2015, this Court extended the stay of proceedings to April 24, 2015 in order to enable WBox and other interested parties to assess their options and to allow the Monitor time to have further discussions with the environmental

regulators. During this extension of the stay period, WBox renewed discussions with the Monitor in respect of a potential transaction that would involve the equity participation of a financial partner. It was discussed that this partner could participate in WBox's nominee, which would be the entity to hold and operate Veris Gold's mining assets.

17 Discussions were also ongoing at this time whereby WBox would provide increased financing to Veris Gold in order to allow further time to finalize a transaction.

18 On April 24, 2015, this Court granted an order extending the stay of proceedings to June 12, 2015. In addition, at the request of the Monitor, an order was granted increasing the interim funding from WBox by US$3 million to US $15 million, which would allow Veris Gold's operations to continue. WBox approved a cash flow forecast and it was agreed that WBox would maintain control over payments made from this further facility. On April 29, 2015, the U.S. court approved this amendment to the interim financing facility.

19 On May 28, 2015, Veris Gold entered into an asset sale agreement (the "Agreement") with WBVG, LLC ("WBVG"). WBVG is an entity wholly owned by WBox although, as anticipated, WBox sought and obtained the future participation of another equity partner. The transaction provides that WBox will transfer a majority interest in WBVG to 2176423 Ontario Ltd., a company owned by Eric Sprott. Mr. Sprott was already involved in Veris Gold, having a 20% equity interest and also having a royalty interest in the Nevada mining properties.

20 The salient terms of the Agreement are as follows:

> a) WBVG will purchase all tangible and intangible assets of Veris Gold, subject to certain defined excluded assets;
>
> b) the Monitor is to continue efforts to sell the Ketza assets in Yukon over a 60-day period with any sale proceeds being payable to WBVG. If no sale occurs, then those assets will be transferred to WBVG;
>
> c) WBVG is to assume certain obligations arising under assumed contracts, including all bonds, and also pay any "cure costs" relating to such assumed contracts, limited to US$10 million;
>
> d) WBVG will assume the amounts owing to WBox under the interim lending facility and will pay certain of the court-ordered charges, such as the administration charges, having priority over the interim lender's charge in favour of WBox to a maximum of US$1.8 million;
>
> e) WBVG will not assume any liabilities for pre-closing obligations;
>
> f) all employees of Veris Gold are to be terminated on closing and WBVG may offer employment to some or all of them; and
>
> g) a "DIP Financing Cash Reserve" fund estimated in the amount of US$3.1 million is to be established to pay certain post-filing obligations that will be outstanding as of the closing date, including employee wages and amounts due to suppliers and contractors for the supply of goods and services. Any funds remaining in the DIP Financing Cash Reserve after these payables have been satisfied shall be returned to WBVG.

21 The Agreement is still conditional in that it is subject to approval by both this Court and the U.S. court. Further conditions relate to obtaining an assignment of certain critical contracts, such as bonding agreements and other arrangements with the Nevada environmental regulators.

Statutory Framework

22 The authority of this Court to approve the sale is found in s. 36 of the *CCAA*. Section 36(3) of the *CCAA* sets out a list of non-exhaustive factors to be considered by the court:

(a) whether the process leading to the proposed sale or disposition was reasonable in the circumstances;

(b) whether the monitor approved the process leading to the proposed sale or disposition;

(c) whether the monitor filed with the court a report stating that in their opinion the sale or disposition would be more beneficial to the creditors than a sale or disposition under a bankruptcy;

(d) the extent to which the creditors were consulted;

(e) the effects of the proposed sale or disposition on the creditors and other interested parties; and

(f) whether the consideration to be received for the assets is reasonable and fair, taking into account their market value.

23 A more general test has been restated, as discerned from the above factors, namely to consider the transaction as a whole and decide "whether or not the sale is appropriate, fair and reasonable": *White Birch Paper Holding Co., Re*, 2010 QCCS 4915 (C.S. Que.) at para. 49, (2010), 72 C.B.R. (5th) 49 (C.S. Que.), leave to appeal ref'd 2010 QCCA 1950 (C.A. Que.).

24 In addition, the principles identified in *Royal Bank v. Soundair Corp.* (1991), 4 O.R. (3d) 1 (Ont. C.A.) at 6 are helpful in considering whether to approve a sale:

1. Whether the party conducting the sale made sufficient efforts to obtain the best price and did not act improvidently;

2. The interests of all parties;

3. The efficacy and integrity of the process by which offers were obtained; and

4. Whether there has been any unfairness in the sales process.

25 Various authorities support that, in considering the test under s. 36 of the *CCAA*, the principles of *Soundair* remain relevant and indeed overlap some of the specific factors set out in s. 36(3): *Canwest Publishing Inc./Publications Canwest Inc., Re*, 2010 ONSC 2870 (Ont. S.C.J. [Commercial List]) at para. 13; *White Birch Paper Holding Co., Re* at para. 50; *PCAS Patient Care Automation Services Inc., Re*, 2012 ONSC 3367 (Ont. S.C.J. [Commercial List]) at para. 54.

Discussion

(a) CCAA Factors

26 I am more than satisfied that the factors set out in s. 36(3) of the *CCAA* support the granting of the order approving the Agreement with WBVG.

27 I have already outlined the extensive process by which Veris Gold's assets were exposed to the market by Moelis in accordance with the court-approved sales process. That process, which took place over many months, unfortunately did not yield any realistic offers, despite an extension of the bid deadline.

28 The Monitor did receive a non-binding expression of interest from a party on May 8, 2015. Some of the persons behind this expression of interest had been involved in the unsuccessful sales process. However, despite the purchase price being slightly above the WBox borrowings (US$20 million), the Monitor's view was that it would not be pursued by reason of the numerous significant conditions and the reality that the delay in pursuing any offer would place Veris Gold's operations at significant risk given its precarious financial (cash) condition. On May 13, 2015, this indicative offer was increased to US$23 million but that increase did not elicit any support from either WBox or the Monitor.

29 In response to the concerns of WBox and the Monitor, this party submitted a non-binding indicative offer on May 22, 2015 with additional materials indicating that financing had been tentatively obtained. Even so, the Monitor supported WBox's continued position that this offer should not be pursued further given the risk and delay in doing so. DB did not challenge this assessment.

30 It should be noted that, with the possible exception of DB, no one was more interested in obtaining an offer to purchase the assets than WBox in terms of seeing some recovery under the interim financing. In large part, WBVG's offer is made somewhat reluctantly by WBox as the only real alternative to obtaining some value from the assets secured under its court-ordered charge.

31 The Monitor has been extensively involved throughout these proceedings and the sales efforts, particularly given the Monitor's role in brokering the peace between Veris Gold and DB that allowed the refinancing and sale efforts to continue without much controversy. To that extent, the Monitor was very much involved in fashioning the sales process that was eventually approved by the court on November 18, 2014.

32 At this time, the stark reality is that no other viable options exist other than this sale or a receivership and liquidation, with the latter providing considerable uncertainty in terms of future operations. That uncertainty has justifiably caused some concern with the regulators, both in Nevada and Yukon, who must necessarily address any environmental issues that might precipitously arise from a failure to continue operations.

33 In my view, the process leading to this transaction was fair and reasonable in the circumstances. No person has suggested that these efforts were insufficient or inadequate.

34 Needless to say, the Monitor, being the applicant, is in favour of the transaction with WBVG and recommends its approval by the court. The Monitor has been involved in the negotiations and finalization of the asset sale agreement throughout.

35 The reasons to approve the sale to WBVG and to do so quickly are outlined in the Monitor's sixteenth report to the court dated May 25, 2015. The portions of the report that highlight those reasons are:

> [Veris Gold] would unlikely be able to recover from a further significant interruption of operations. The result would likely be the commencement of a liquidation process with the resultant loss of jobs, supply chain benefits and heightened environmental risks related to the need to transition care and maintenance activities to the Nevada environmental regulators on an extremely short timeline.
>
> . . .
>
> The [transaction] is essentially a realization process by [WBox], which has no viable alternatives. The operations continue on borrowed time, and prolonging any process results, in the Monitor's view, in significant risk to numerous stakeholders - [WBox], employees, suppliers of goods and services, and the environmental regulators.
>
> . . .
>
> [I]t is urgent to have an expedited resolution to these proceedings. ... The alternative, which would involve facilitating due diligence by the EOI Party or other late emerging parties, together with the related purchase agreement negotiations and discussions with the environmental regulators, translates into an extended timeframe and a higher risk of non-completion or future operational disruption. The party exposed to the risk of loss in the event on non-completion is [WBox].

36 There has obviously been extensive consultation with WBox throughout these proceedings since the interim financing was initially approved in October 2014.

37 Since February 2015, when it was clear that no sales had materialized, DB's interest in these proceedings has undoubtedly lessened. This is largely due to the realization that there was likely no value beyond what was owed to WBox under its interim financing, which stands in priority to the secured debt of DB. In essence, DB's lack of opposition to this sale is in recognition that it will obtain no recovery of the substantial debt owed by Veris Gold to it in excess of US$90 million.

38 Other creditors junior in priority to DB have not been consulted; however, it has been abundantly clear since January 2015 that DB stood little chance of collecting even a portion of its debt, let alone realize a refinancing or sale that would see these junior creditors recover from any excess. Therefore, the proposed transaction will have no material effect on these other creditors.

39 It has also necessarily been the case that the various parties, and in particular the Monitor, WBox, Mr. Sprott and WBVG, have been in extensive discussions with the environmental regulators throughout these proceedings and specifically regarding the proposed transaction with WBVG. Discussions were held with the Nevada Division of Environmental Protection and the U.S. Forest Service in connection with the proposed transaction and any alternative scenarios. Those regulators were either in support or not opposed to the relief sought on this application, having secured terms in the proposed court order to address any concerns on their part.

40 While the outcome for DB and other pre-filing creditors is complete non-recovery, the benefits for various other stakeholders, being WBox, the employees, suppliers and the environmental regulators, is evident enough. It is these stakeholders who will suffer in the event that Veris Gold's operations do not continue and the environmental regulators in Nevada are left with the significant care and maintenance responsibilities for the mine site in a liquidation scenario. This transaction will see a continuation of Veris Gold's operations in Nevada. Accordingly, I agree with the Monitor that this is the best outcome for these operational stakeholders.

41 The operations in Yukon have been dormant for some time. Discussions between the Monitor and the Yukon regulators are continuing at this time toward a potential purchase of the Ketza assets by Yukon and a relinquishment of Veris Gold's mineral claims and mining leases there. The Agreement contemplates that these discussions will continue, hopefully toward a satisfactory conclusion.

42 The Monitor and WBox have also addressed in part concerns expressed by the court concerning the ongoing supply of goods and services and the uncertainty of payment for those goods and services while the Agreement was being negotiated. As noted above, upon the closing of the transaction, employees and suppliers to the Nevada mine site will be paid by Veris Gold for goods and services supplied up to the time of closing. As it relates to the employees, this addresses the requirement in the *CCAA*, s. 36(7) in that the court is satisfied that employee-related claims will be paid. Additional benefits will also redound to all of these stakeholders by either the potential of continued employment with WBVG or the continuation of many of the supply contracts which are to be assumed by WBVG post-closing.

43 I also conclude that the history of these proceedings, as outlined above, demonstrates that the consideration to be received for Veris Gold's assets is reasonable and fair, taking into account their market value. While no appraisals of the assets have been obtained, that fair market value is reflected in the market response to the extensive sales efforts undertaken.

44 No one misunderstands that if the transaction is not approved WBox will withdraw funding and Veris Gold will almost certainly have to commence an orderly wind down of its operations and liquidation of its assets to satisfy the debt owed to WBox. It is more than likely that WBox will suffer a shortfall in a liquidation scenario. A liquidation scenario will also likely result in the Nevada environmental regulators taking over care and maintenance of the mine site on an expedited basis, at significant expense and with the possibility of environmental damage resulting from a surrender of the mine site without the lead time needed by the regulators.

45 In all the circumstances, a consideration of all the factors in s. 36 of the *CCAA* supports the conclusions that the proposed transaction is fair and reasonable and that the Agreement should be approved.

(b) Assignment of Contracts

46 The asset sale agreement provides that WBVG will be assigned the "Assigned Contracts", which are defined as meaning "all Designated Seller Contracts" and also described as "Required Assigned Contracts". All of these contracts are listed in a schedule attached to the purchaser disclosure schedule delivered by WBVG to Veris Gold.

47 The Monitor seeks approval of the assignment of the Designated Seller Contracts, save to the extent that consents from counterparties have not already been obtained.

48 The relevant statutory authority to approve such assignments is found in s. 11.3 of the *CCAA*:

> 11.3 (1) On application by a debtor company and on notice to every party to an agreement and the monitor, the court may make an order assigning the rights and obligations of the company under the agreement to any person who is specified by the court and agrees to the assignment.
>
> . . .
>
> (3) In deciding whether to make the order, the court is to consider, among other things,
>
> (a) whether the monitor approved the proposed assignment;
>
> (b) whether the person to whom the rights and obligations are to be assigned would be able to perform the obligations; and
>
> (c) whether it would be appropriate to assign the rights and obligations to that person.
>
> (4) The court may not make the order unless it is satisfied that all monetary defaults in relation to the agreement — other than those arising by reason only of the company's insolvency, the commencement of proceedings under this Act or the company's failure to perform a non-monetary obligation — will be remedied on or before the day fixed by the court.
>
> (5) The applicant is to send a copy of the order to every party to the agreement.

49 The Monitor's report and recommendations are in support of approval of these assignments. These approvals are part of the Monitor's overall recommendations in favour of the Agreement. WBVG has indicated its willingness to continue the operations of Veris Gold in Nevada on a going concern basis. The participation of WBox and Mr. Sprott lend credibility to its ability to do so, while performing any obligations under these contracts.

50 In that context, it is appropriate that WBVG obtain the benefit of contracts that will facilitate its ability to continue these operations. Indeed, some of the contracts are critical or necessary for future operations.

51 In addition, the Agreement contemplates the payment of "cure costs" which are defined in the Agreement in relation to statutory obligations arising under both s. 11.3(4) of the *CCAA* and s. 365(b)(1) of the *Bankruptcy Code* where the assignment of contracts is approved. Cure costs are defined in the Agreement as follows:

> "Cure Cost" means, as applicable with respect to any Seller, (i) any amounts or assurances required by Section 365(b)(1) of the U.S. Bankruptcy Code under any applicable Designated Seller Contract or (ii) any amounts required to satisfy monetary defaults in relation to the applicable Designated Seller Contract pursuant to Section 11.3 of the CCAA.

52 Each of the Designated Seller Contracts and related anticipated cure costs are set out in a schedule to the Agreement. Pursuant to the Agreement, such cure costs are payable on closing. The order sought provides that upon payment, and upon assignment:

> 10. ... the Required Assigned Contracts [aka the Designated Seller Contracts] shall be deemed valid and binding and in full force and effect at the Closing, and the Purchaser shall enjoy all of the rights and benefits under each such Required Assigned Contract as of the applicable date of assumption.

53 Section 11.3 of the *CCAA* came into force in September 2009. Prior to that time, there was little case authority in terms of a *CCAA* court approving assignments of contracts over the objections of counterparties. One of those early cases is *Playdium Entertainment Corp., Re* (2001), 31 C.B.R. (4th) 302 (Ont. S.C.J. [Commercial List]); additional reasons (2001), 31 C.B.R. (4th) 309 (Ont. S.C.J. [Commercial List]).

54 In *Nexient Learning Inc., Re* (2009), 62 C.B.R. (5th) 248 (Ont. S.C.J.) at 258, Wilton-Siegel J. cited both Spence J. in *Playdium Entertainment Corp., Re* and Tysoe J. (as he then was) in *Woodward's Ltd., Re* (1993), 79 B.C.L.R. (2d) 257 (B.C. S.C.), in framing the test as being whether the assignment was "important to the reorganization process". Also of relevance was the effect of the assignment on the counterparty and the principle that third party rights should only be affected as is absolutely required to assist in the reorganization and in a manner fair to that counterparty: see the additional reasons in *Playdium Entertainment Corp., Re* at 319; *Nexient Learning Inc., Re* at 259. See also discussion in *Barafield Realty Ltd. v. Just Energy (B.C.) Limited Partnership*, 2014 BCSC 945 (B.C. S.C.) at paras. 107-108.

55 The approach of the courts in these earlier cases was essentially confirmed in *Ted Leroy Trucking Ltd., Re*, 2010 SCC 60 (S.C.C.), where the Court stated the basis upon which relief might be "appropriate" and that any relief should result in "fair" treatment to all stakeholders:

> [70] 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. 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. 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.]

56 Like many other amendments to the *CCAA* in September 2009, s. 11.3 was intended, in my view, to codify what had been the general approach to assignment issues, while also clarifying certain matters that had been to that time uncertain. One example of certainty achieved, although irrelevant on this application, arises by s. 11.3(2) which excludes certain contracts from the statutory authority of the court in s. 11.3(1).

57 Since its enactment, judicial consideration of s. 11.3 is scarce. In *TBS Acquireco Inc., Re*, 2013 ONSC 4663 (Ont. S.C.J. [Commercial List]), D.M. Brown J. (as he then was) approved the assignment of certain leases and designated contracts, finding that this would result in the continuation of the business in the greatest number of stores and the continued employment of the greater number of people. Cure costs were also to be paid: see paras. 19-25.

58 I do not see the result in *TBS Acquireco Inc., Re* as deviating from the previous approach of the courts in considering whether to approve an assignment based on the twin goals of assisting the reorganization process (i.e., the sale in this case) while also treating a counterparty fairly and equitably. These considerations can be discerned in particular from the factors set out in s. 11.3(3) set out above.

59 That brings me to the only issue that arises here in relation to the assignments. While no objection was raised to the assignments by persons who did not otherwise consent, the Monitor's counsel was candid in advising the court that only those persons on the service list were served with the Canadian application materials. It is not therefore apparent that the counterparties to the contracts did in fact receive a copy of the application materials.

60 This is not an approach that I would endorse. It may often be the case that a counterparty is not a creditor of the estate and therefore, that party would not get notice of the filing at the commencement of those proceedings. Further, even if that is the case, no assignment issue may be apparent at the time of initial service to the point that such person would take steps to be placed on the service list.

61 The best practice in these circumstances is to serve all counterparties to the particular contracts that are sought to be assigned, whether they are on the service list or not. Section 11.3(1) specifically provides that the application is to be "on notice to every party to an agreement". Common sense dictates that the person to be directly affected by the assignment should have the ability to consider whether the applicant debtor company has satisfied its burden that the order is appropriate, including the factors set out in s. 11.3(3). Only by service will that counterparty be made aware of the need to consider its position if such approval is granted and possibly advance evidence and considerations that would be equally relevant to the court's decision on the issue.

62 Before proceeding with the application in *TBS Acquireco Inc., Re* , Brown J. was satisfied that the applicant had given notice of the request to seek a court-authorized assignment of the contracts: para. 25.

63 As I have mentioned, there was urgency in approving the Agreement so that Veris Gold's operations could continue in the ordinary course. Further delay was not feasible nor was it in the interests of all the stakeholders. The Monitor's counsel advised that all of the counterparties were in the U.S. and most of those counterparties, being capital lessors, were represented by Nevada counsel. Finally, I was advised that all of these counterparties were served with the U.S. application materials in anticipation of an application in Nevada to also approve the Agreement immediately after this application. Therefore, specific notice of the terms of the Agreement and the fact that approval of the assignment was sought would have been provided in any event, albeit in the context of the U.S. court materials.

64 In these exigent and extraordinary circumstances, I approved the assignments on the terms sought, but subject to the U.S. court being satisfied with the notification to and service on the counterparties to the Required Assigned Contracts who did not receive direct notice of this application. In that way, these counterparties will have been given the ability to attend the U.S. hearing and make submissions on the relief sought, all of which is a required condition to closing the Agreement.

Conclusion

65 Veris Gold has faced a number of operational challenges and adverse events over the course of this restructuring proceeding. Initially at least, they faced significant opposition by their major secured creditor, DB. Efforts to refinance or sell the assets have been met with little interest and certainly no offer was received by that process on which to base a transaction.

66 As matters stand, Veris Gold's operations are undercapitalized and susceptible to further disruptions unless stability is achieved quickly to avoid a liquidation process. That process would undoubtedly result in a loss of jobs, disruption of supply arrangements and heightened environmental risk.

67 The only realistic alternative is the one before the court on this application; namely, a credit bid by WBox, the interim lender, which would see a continuation of the operations in Nevada. The Monitor's view is that proceeding to close the Agreement on an expedited basis is necessary to protect the interests of the principal stakeholders in Veris Gold's operations, namely WBox, the employees, suppliers of goods and services and the environmental regulators.

68 The statutory requirements of the *CCAA* in ss. 36 and 11.3 have been satisfied by the Monitor toward approval of the Agreement, including approving the assignments of the Required Assigned Contracts. I am also satisfied that the orders sought are appropriate in the circumstances and consistent with the objectives of the *CCAA*.

69 The relief sought by the Monitor is granted. The Agreement is approved and Veris Gold and the Monitor are authorized to proceed to finalize the transactions with WBVG. The vesting of the assets on closing will be subject to an order of the U.S. court approving the Agreement and making such other ancillary orders as are appropriate in accordance with the *Bankruptcy Code*. The order provides that any issues that may be raised by the U.S. environmental regulators will be addressed by the U.S. court. Accordingly, this Court requests the aid, recognition and assistance of the U.S. court in terms of the carrying out of the terms of the order granted.

70 Finally, all orders sought with respect to the approval of the assignment by Veris Gold to WBVG of the Required Assigned Contracts are granted on the terms sought, including that such approval is subject to the payment of the cure costs.

Application granted.

End of Document

TAB 10

1998 CarswellOnt 1
Supreme Court of Canada

Rizzo & Rizzo Shoes Ltd., Re

1998 CarswellOnt 1, 1998 CarswellOnt 2, [1998] 1 S.C.R. 27, [1998] S.C.J. No. 2, 106 O.A.C. 1, 154 D.L.R. (4th) 193, 221 N.R. 241, 33 C.C.E.L. (2d) 173, 36 O.R. (3d) 418 (headnote only), 50 C.B.R. (3d) 163, 76 A.C.W.S. (3d) 894, 98 C.L.L.C. 210-006, J.E. 98-201

Philippe Adrien, Emilia Berardi, Paul Creador, Lorenzo Abel Vasquez and Lindy Wagner on their own behalf and on behalf of the other former employees of Rizzo & Rizzo Shoes Limited, Appellants v. Zittrer, Siblin & Associates, Inc., Trustees in Bankruptcy of the Estate of Rizzo & Rizzo Shoes Limited, Respondent and The Ministry of Labour for the Province of Ontario, Employment Standards Branch, Party

Gonthier, Cory, McLachlin, Iacobucci, Major JJ.

Heard: October 16, 1997
Judgment: January 22, 1998
Docket: 24711

Proceedings: reversing (1995), 30 C.B.R. (3d) 1 (C.A.); reversing (1991), 11 C.B.R. (3d) 246 (Ont. Gen. Div.)

Counsel: *Steven M. Barrett* and *Kathleen Martin*, for the appellants.
Raymond M. Slattery, for the respondent.
David Vickers, for the Ministry of Labour for the Province of Ontario, Employment Standards Branch.

Subject: Employment; Insolvency

Headnote

Bankruptcy --- Priorities of claims — Preferred claims — Wages and salaries of employees — Type of wages claimable

Trustee in bankruptcy closed bankruptcy employer's stores and paid employees all outstanding wages, commissions and vacation pay up to termination date — Ministry of Labour determined that employees were owed termination and severance pay, and filed claim with trustee which trustee disallowed — Court of Appeal ultimately upheld trustee's disallowance — Employees appealed — Appeal allowed — Termination resulting from bankruptcy gave rise to unsecured provable claim for termination and severance pay — Bankruptcy and Insolvency Act, R.S.C. 1985, c. B-3, s. 121 — Employment Standards Act, R.S.O. 1980, c. 137, ss. 40(1), 40(7), 40a — Employment Standards Amendment Act, 1981, S.O. 1981, c. 22, s. 2(3) — Interpretation Act, R.S.O. 1990, c. I.11, s. 10.

Employment law --- Termination and dismissal — Termination of employment by employer — Severance pay under employment standards legislation

Trustee in bankruptcy closed bankruptcy employer's stores and paid employees all outstanding wages, commissions and vacation pay up to termination date — Ministry of Labour determined that employees were owed termination and severance pay, and filed claim with trustee which trustee disallowed — Court of Appeal ultimately upheld trustee's disallowance — Employees appealed — Appeal allowed — Termination resulting from bankruptcy gave rise to unsecured provable claim for termination and severance pay — Bankruptcy and Insolvency Act, R.S.C. 1985, c. B-3, s. 121 — Employment Standards Act, R.S.O. 1980, c. 137, ss. 40 (1), 40(7), 40a — Employment Standards Amendment Act, 1981, S.O. 1981, c. 22, s. 2(3) — Interpretation Act, R.S.O. 1990, c. I.11, s. 10.

Faillite --- Priorité des créances — Créances prioritaires — Traitements et salaires des employés — Types de traitements exigibles

Syndic a procédé à la fermeture des magasins du failli et a payé tous les traitements, commissions et paies de vacances dus aux employés jusqu'à la date de cessation d'emploi — Ministère du travail a déterminé que les employés avaient droit à une indemnité de cessation d'emploi et a présenté une preuve de réclamation au syndic, lequel a rejeté la preuve de réclamation — Ultérieurement, la Cour d'appel a confirmé la décision du syndic — Employés ont formé un pourvoi — Pourvoi a été accueilli — Cessation d'emploi résultant de la faillite donnait lieu à une réclamation prouvable ordinaire au titre des indemnités de cessation d'emploi — Loi sur la faillite et l'insolvabilité, L.R.C. 1985, c. B-3, art. 121 — Loi sur les normes d'emploi, L.R.O. 1980, c. 137, art. 40(1), 40(7), 40a — Employment Standards Amendment Act, 1981, L.O. 1981, c. 22, art. 2(3) — Loi d'interprétation, L.R.O. 1990, c. I.11, art. 10.

Droit du travail --- Cessation d'emploi et indemnité de congédiement — Résiliation du contrat d'emploi par l'employeur — Indemnité de cessation d'emploi en vertu de la législation sur les normes du travail

Syndic a procédé à la fermeture des magasins du failli et a payé tous les traitements, commissions et paies de vacances dus aux employés jusqu'à la date de cessation d'emploi — Ministère du travail a déterminé que les employés avaient droit à une indemnité de cessation d'emploi et a présenté une preuve de réclamation au syndic, lequel a rejeté la preuve de réclamation — Ultérieurement, la Cour d'appel a confirmé la décision du syndic — Employés ont formé un pourvoi — Pourvoi a été accueilli — Cessation d'emploi résultant de la faillite donnait lieu à une réclamation prouvable ordinaire au titre des indemnités de cessation d'emploi — Loi sur la faillite et l'insolvabilité, L.R.C. 1985, c. B-3, art. 121 — Loi sur les normes d'emploi, L.R.O. 1980, c. 137, art. 40(1), 40(7), 40a — Employment Standards Amendment Act, 1981, L.O. 1981, c. 22, art. 2(3) — Loi d'interprétation, L.R.O. 1990, c. I.11, art. 10.

An employer which operated a chain of shoe stores was petitioned into bankruptcy on April 13, 1989. A receiving order was made the following day, and on that day the employment of the employer's employees ended. The trustee in bankruptcy paid all wages, salaries, commissions, and vacation pay which had been earned by the employees up to the date on which the receiving order was made. A few months later, the provincial Ministry of Labour audited the employer' records, and determined that the former employees were owed termination pay and vacation pay thereon. The Ministry accordingly filed a proof of claim for these amounts with the trustee. The trustee subsequently disallowed the claims, inter alia, on the grounds that the bankruptcy of the employer did not constitute a dismissal of the employees from employment; thus, no entitlement to severance, termination or vacation pay was triggered under the *Employment Standards Act* (the "ESA"), and there was no claim provable in bankruptcy. The Ministry's appeal to the Ontario Court of Justice (General Division) was allowed. On appeal to the Ontario Court of Appeal, the court overturned the decision and restored the trustee's decision. The employees resumed an appeal to the Supreme Court of Canada which had been discontinued by the Ministry.

Held: The appeal was allowed.

Section 40(7) of the ESA provided that where an employee's employment was terminated contrary to the ESA's minimum notice provisions, the employer was required to pay termination pay equal to the amount the employee would have received for the applicable notice period. Section 40a of the ESA further provided that the employer must pay severance pay to each employee whose employment had been terminated, and who had been employed for five years or more. Section 2(3) of the *Employment Standards Amendment Act, 1981* (the "ESAA"), which enacted s. 40a of the ESA, also included a transitional provision such that the amendments did not apply to bankrupt or insolvent employers whose assets had been distributed among creditors or whose proposal under the *Bankruptcy Act* (the "BA") had been accepted prior to the day the amendments received royal assent. A fair, large, and liberal construction of the words "terminated by the employer" was mandated by s. 10 of the *Interpretation Act* if the provisions of the ESA were to be given a meaning consistent with its spirit, purpose, and intention. The purpose of the various provisions of the ESA is to protect employees against the adverse effects of economic dislocation likely to follow from the absence of an opportunity to search for alternative employment. Interpreting ss. 40 and 40a of

the ESA to apply only to non-bankruptcy-related terminations was incompatible with the object of that statute, and the objects of the termination and severance pay provisions themselves. Moreover, if the ESA's amendments were not intended to apply to terminations caused by operation of the BA, then the transitional provisions of s. 2(3) of the ESAA would have no readily apparent purpose. The inclusion of s. 2(3) of the ESAA necessarily implied that the severance pay obligation did in fact extend to bankrupt employers. To limit the application of those provisions only to employees not terminated through bankruptcy would lead to absurd results, and defeat the purpose of the ESA. Therefore, termination as a result of an employer's bankruptcy does give rise to an unsecured claim provable in bankruptcy pursuant to s. 121 of the BA for termination and severance pay in accordance with ss. 40 and 40a of the ESA. A declaration that the employer's former employees were entitled to make claims for termination pay, including vacation pay due thereon and severance pay as unsecured creditors, was substitued for the order of the Court of Appeal.

Un employeur, qui exploitait une chaîne de magasins, a fait l'objet de procédures en faillite et a été déclaré failli en date du 13 avril 1989. Une ordonnance de séquestre a été émise le jour suivant et c'est à ce moment que les contrats d'emploi entre l'employeur et ses employés ont pris fin. Le syndic a versé tous les traitements, salaires, commissions et paies de vacances gagnés par les employés à la date de l'ordonnance de séquestre. Quelques mois plus tard, le ministère du Travail de la province a procédé à la vérification des livres de l'employeur et déterminé que les employés avaient droit à une indemnité de cessation d'emploi de même que le montant y afférent à titre de paie de vacances. Le ministère a donc soumis une preuve de réclamation à l'égard de ces montants au syndic. Le syndic a rejeté la preuve de réclamation au motif, notamment, que la faillite ne constituait pas un congédiement des employés, et ne donnait donc pas droit à une indemnité de cessation d'emploi, une indemnité de licenciement ni une paie de vacances en vertu de la *Loi sur les normes d'emploi* (la « LNE »). Par conséquent, il ne pouvait y avoir de réclamation prouvable à ce titre. Le pourvoi du ministère à la Cour de l'Ontario (Division générale) a été accueilli. En appel à la Cour d'appel de l'Ontario, la Cour a infirmé le jugement de première instance et a confirmé la décision du syndic. Le ministère s'est désisté de son pourvoi et les employés ont repris le pourvoi à la Cour suprême du Canada.

Arrêt: Le pourvoi a été accueilli.

L'article 40(7) de la LNE prévoyait que, lorsque le contrat d'emploi était résilié sans respecter les dispositions de la LNE relatives à l'avis minimal de cessation d'emploi, l'employeur était tenu de verser une indemnité égale au montant que l'employé aurait reçu pour la période d'avis applicable. D'autre part, l'art. 40a de la LNE prévoyait que l'employeur devait verser une indemnité de cessation d'emploi à chaque employé dont le contrat d'emploi a été résilié et qui travaillait pour l'employeur depuis cinq ans ou plus. L'article 2(3) de la *Employment Standards Amendment Act, 1981* (la « ESAA »), qui édictait l'entrée en vigueur l'art. 40a de la LNE, comprenait aussi une disposition transitoire afin que les amendements ne s'appliquent pas aux employeurs faillis ou insolvables dont les biens avaient été distribués aux créanciers et dont la proposition concordataire en vertu de la *Loi sur la faillite et l'insolvabilité* (la « LFI ») avait été acceptée avant le jour où les amendements ont reçu la sanction royale. L'article 10 de la *Loi d'interprétation* commandait une interprétation juste, généreuse et libérale des mots « l'employeur licencie » afin que les dispositions de la LNE aient un sens qui s'accorde avec l'esprit, l'objet et l'intention de cette loi. L'objectif des diverses dispositions de la LNE est de protéger les employés contre les effets nuisibles d'un bouleversement économique soudain qui peuvent survenir en raison de l'absence de la possibilité de chercher un autre emploi. Interpréter les art. 40 et 40a de la LNE de manière à ce qu'ils s'appliquent uniquement lorsque des cessations d'emploi ne résultent pas d'une faillite était contraire à l'objet de cette loi et même à l'objet des dispositions sur l'indemnité de cessation d'emploi. En outre, si les amendements à la LNE n'étaient pas censés s'appliquer aux cessations d'emploi opérées par la LFI, alors les dispositions transitoires de l'art. 2(3) de la ESAA sembleraient dépourvues d'objet. L'inclusion de l'art. 2(3) de la ESAA impliquait nécessairement que l'obligation de verser une indemnité de cessation d'emploi s'étendait aussi aux employeurs faillis. Restreindre l'application de ces dispositions aux seuls employés non licenciés par suite d'une faillite mènerait à des résultats absurdes et viderait la LNE de son objet. Ainsi, aux termes de l'art. 121 de la LFI, la cessation d'emploi découlant de la faillite de l'employeur donne

lieu à une réclamation prouvable ordinaire dans la faillite, à titre d'indemnité de licenciement et d'indemnité de cessation d'emploi, conformément aux art. 40 et 40a de la LNE. Une ordonnance déclarant que les anciens employés de l'employeur ont le droit de présenter des demandes d'indemnité de licenciement, y compris la paie de vacances y afférent, et des demandes d'indemnité de cessation d'emploi en tant que créanciers ordinaires a été substituée à l'ordonnance de la Cour d'appel.

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s. 17 — considered

Labour Relations and Employment Statute Law Amendment Act, 1995/Relations de travail et l'emploi, Loi de 1995 modifiant des lois en ce qui concerne les, S.O./L.O. 1995, c. 1
s. 74(1) — considered

s. 75(1) — considered

APPEAL by employees of bankrupt employer from decision reported at (1995), 30 C.B.R. (3d) 1, 9 C.C.E.L. (2d) 264, 22 O.R. (3d) 385, *(*sub nom. *Ontario Ministry of Labour v. Rizzo & Rizzo Shoes Ltd.)* 95 C.L.L.C. 210-020, *(*sub nom. *Re Rizzo & Rizzo Shoes Ltd. (Bankrupt))* 80 O.A.C. 201 (C.A.), reversing decision reported at (1991), 11 C.B.R. (3d) 246, 6 O.R. (3d) 441, 92 C.L.L.C. 14,013 (Gen. Div.), reversing disallowance of claim by trustee in bankruptcy.

POURVOI interjeté par les employés d'un employeur failli à l'encontre d'un arrêt publié à (1995), 30 C.B.R. (3d) 1, 9 C.C.E.L. (2d) 264, 22 O.R. (3d) 385, *(*sub nom. *Ontario Ministry of Labour v. Rizzo & Rizzo Shoes Ltd.)* 95 C.L.L.C. 210-020, *(*sub nom. *Re Rizzo & Rizzo Shoes Ltd. (Bankrupt))* 80 O.A.C. 201 (C.A.), infirmant un arrêt publié à (1991), 11 C.B.R. (3d) 246, 6 O.R. (3d) 441, 92 C.L.L.C. 14,013 (Gen. Div.), infirmant le rejet par le syndic d'une preuve de réclamation dans la faillite.

The judgment of the court was delivered by *Iacobucci J.*:

1 This is an appeal by the former employees of a now bankrupt employer from an order disallowing their claims for termination pay (including vacation pay thereon) and severance pay. The case turns on an issue of statutory interpretation. Specifically, the appeal decides whether, under the relevant legislation in effect at the time of the bankruptcy, employees are entitled to claim termination and severance payments where their employment has been terminated by reason of their employer's bankruptcy.

1. Facts

2 Prior to its bankruptcy, Rizzo & Rizzo Shoes Limited ("Rizzo") owned and operated a chain of retail shoe stores across Canada. Approximately 65% of those stores were located in Ontario. On April 13, 1989, a petition in bankruptcy was filed against the chain. The following day, a receiving order was made on consent in respect of Rizzo's property. Upon the making of that order, the employment of Rizzo's employees came to an end.

3 Pursuant to the receiving order, the respondent, Zittrer, Siblin & Associates, Inc. (the "Trustee") was appointed as trustee in bankruptcy of Rizzo's estate. The Bank of Nova Scotia privately appointed Peat Marwick Limited ("PML") as receiver and manager. By the end of July, 1989, PML had liquidated Rizzo's property and assets and closed the stores. PML paid all wages, salaries, commissions and vacation pay that had been earned by Rizzo's employees up to the date on which the receiving order was made.

4 In November 1989, the Ministry of Labour for the Province of Ontario (Employment Standards Branch) (the "Ministry") audited Rizzo's records to determine if there was any outstanding termination or severance pay owing to former employees under the *Employment Standards Act*, R.S.O. 1980, c. 137, as amended (the "*ESA*"). On August 23, 1990, the Ministry delivered a proof of claim to the respondent Trustee on behalf of the former employees of Rizzo for termination pay and vacation pay thereon in the amount of approximately $2.6 million and for severance pay totalling $14,215. The Trustee disallowed the claims, issuing a Notice of Disallowance on January 28, 1991. For the purposes of this appeal, the relevant ground for disallowing the claim was the Trustee's opinion that the bankruptcy of an employer does not constitute a dismissal from employment and thus, no entitlement to severance, termination or vacation pay is created under the *ESA*.

5 The Ministry appealed the Trustee's decision to the Ontario Court (General Division) which reversed the Trustee's disallowance and allowed the claims as unsecured claims provable in bankruptcy. On appeal, the Ontario Court of Appeal overturned the trial court's ruling and restored the decision of the Trustee. The Ministry sought leave to appeal from the Court of Appeal judgment, but discontinued its application on August 30, 1993. Following the discontinuance of the appeal, the Trustee paid a dividend to Rizzo's creditors, thereby leaving significantly less funds in the estate. Subsequently, the appellants, five former employees of Rizzo, moved to set aside the discontinuance, add themselves as parties to the proceedings, and requested an order granting them leave to appeal. This Court's order granting those applications was issued on December 5, 1996.

2. Relevant Statutory Provisions

6 The relevant versions of the *Bankruptcy Act* (now the *Bankruptcy and Insolvency Act*) and the *Employment Standards Act* for the purposes of this appeal are R.S.C. 1985, c. B-3 (the "*BA*"), and R.S.O. 1980, c. 137, as amended to April 14, 1989 (the "*ESA*") respectively:

Employment Standards Act, R.S.O. 1980, c. 137, as amended:

7.--

(5) Every contract of employment shall be deemed to include the following provision:

> All severance pay and termination pay become payable and shall be paid by the employer to the employee in two weekly instalments beginning with the first full week following termination of employment and shall be allocated to such weeks accordingly. This provision does not apply to severance pay if the employee has elected to maintain a right of recall as provided in subsection 40a (7) of the *Employment Standards Act*.

40.-- (1) No employer shall terminate the employment of an employee who has been employed for three months or more unless the employee gives,

(a) one weeks notice in writing to the employee if his or her period of employment is less than one year;

(b) two weeks notice in writing to the employee if his or her period of employment is one year or more but less than three years;

(c) three weeks notice in writing to the employee if his or her period of employment is three years or more but less than four years;

(d) four weeks notice in writing to the employee if his or her period of employment is four years or more but less than five years;

(e) five weeks notice in writing to the employee if his or her period of employment is five years or more but less than six years;

(f) six weeks notice in writing to the employee if his or her period of employment is six years or more but less than seven years;

(g) seven weeks notice in writing to the employee if his or her period of employment is seven years or more but less than eight years;

(h) eight weeks notice in writing to the employee if his or her period of employment is eight years or more,

and such notice has expired.

. . . . .

(7) Where the employment of an employee is terminated contrary to this section,

(a) the employer shall pay termination pay in an amount equal to the wages that the employee would have been entitled to receive at his regular rate for a regular non-overtime work week for the period of notice prescribed by subsection (1) or (2), and any wages to which he is entitled;

. . . . .

40*a* ...

(1a) Where,

(a) fifty or more employees have their employment terminated by an employer in a period of six months or less and the terminations are caused by the permanent discontinuance of all or part of the business of the employer at an establishment; or

(b) one or more employees have their employment terminated by an employer with a payroll of $2.5 million or more,

the employer shall pay severance pay to each employee whose employment has been terminated and who has been employed by the employer for five or more years.

Employment Standards Amendment Act, 1981, S.O. 1981, c. 22

2.--(1) Part XII of the said Act is amended by adding thereto the following section:

(3) Section 40*a* of the said Act does not apply to an employer who became a bankrupt or an insolvent person within the meaning of the *Bankruptcy Act* (Canada) and whose assets have been distributed among his creditors or to an employer whose proposal within the meaning of the *Bankruptcy Act* (Canada) has been accepted by his creditors in the period from and including the 1st day of January, 1981, to and including the day immediately before the day this Act receives Royal Assent.

Bankruptcy Act, R.S.C. 1985, c. B-3

> **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.

Interpretation Act, R.S.O. 1990, c. I.11

> **10.** Every Act shall be deemed to be remedial, whether its immediate purport is to direct the doing of any thing that the Legislature deems to be for the public good or to prevent or punish the doing of any thing that it deems to be contrary to the public good, and shall accordingly receive such fair, large and liberal construction and interpretation as will best ensure the attainment of the object of the Act according to its true intent, meaning and spirit.
>
> . . . . .
>
> **17.** The repeal or amendment of an Act shall be deemed not to be or to involve any declaration as to the previous state of the law.

3. Judicial History

A. Ontario Court (General Division) (1991), 6 O.R. (3d) 441 (Ont. Gen. Div.)

7 Having disposed of several issues which do not arise on this appeal, Farley J. turned to the question of whether termination pay and severance pay are provable claims under the *BA*. Relying on *U.F.C.W., Local 617P v. Royal Dressed Meats Inc. (Trustee of)* (1989), 76 C.B.R. (N.S.) 86 (Ont. S.C.), he found that it is clear that claims for termination and severance pay are provable in bankruptcy where the statutory obligation to provide such payments arose prior to the bankruptcy. Accordingly, he reasoned that the essential matter to be resolved in the case at bar was whether bankruptcy acted as a termination of employment thereby triggering the termination and severance pay provisions of the *ESA* such that liability for such payments would arise on bankruptcy as well.

8 In addressing this question, Farley J. began by noting that the object and intent of the *ESA* is to provide minimum employment standards and to benefit and protect the interests of employees. Thus, he concluded that the *ESA* is remedial legislation and as such it should be interpreted in a fair, large and liberal manner to ensure that its object is attained according to its true meaning, spirit and intent.

9 Farley J. then held that denying employees in this case the right to claim termination and severance pay would lead to the arbitrary and unfair result that an employee whose employment is terminated just prior to a bankruptcy would be entitled to termination and severance pay, whereas one whose employment is terminated by the bankruptcy itself would not have that right. This result, he stated, would defeat the intended working of the *ESA*.

10 Farley J. saw no reason why the claims of the employees in the present case would not generally be contemplated as wages or other claims under the *BA*. He emphasized that the former employees in the case at bar had not alleged that termination pay and severance pay should receive a priority in the distribution of the estate, but merely that they are provable (unsecured and unpreferred) claims in a bankruptcy. For this reason, he found it inappropriate to make reference to authorities whose focus was the interpretation of priority provisions in the *BA*.

11 Even if bankruptcy does not terminate the employment relationship so as to trigger the *ESA* termination and severance pay provisions, Farley J. was of the view that the employees in the instant case would nevertheless be entitled to such payments as these were liabilities incurred prior to the date of the bankruptcy by virtue of s. 7(5) of the *ESA*. He found that s. 7(5) deems every employment contract to include a provision to provide termination and severance pay following the termination of employment and concluded that a contingent obligation is thereby created for a bankrupt employer to make such payments from the outset of the relationship, long before the bankruptcy.

12 Farley J. also considered s. 2(3) of the *Employment Standards Amendment Act, 1981*, S.O. 1981, c. 22 (the "*ESAA*"), which is a transitional provision that exempted certain bankrupt employers from the newly introduced severance pay obligations until the amendments received royal assent. He was of the view that this provision would not have been necessary if the obligations of employers upon termination of employment had not been intended to apply to bankrupt employers under the *ESA*. Farley J. concluded that the claim by Rizzo's former employees for termination pay and severance pay could be provided as unsecured and unpreferred debts in a bankruptcy. Accordingly, he allowed the appeal from the decision of the Trustee.

B. Ontario Court of Appeal (1995), 22 O.R (3d) 385

13 Austin J.A., writing for a unanimous court, began his analysis of the principal issue in this appeal by focussing upon the language of the termination pay and severance pay provisions of the *ESA*. He noted, at p. 390, that the termination pay provisions use phrases such as "[n]o employer shall terminate the employment of an employee" (s. 40(1)), "the notice required by an employer to terminate the employment" (s. 40(2)), and "[a]n employer who has terminated or proposes to terminate the employment of employees" (s. 40(5)). Turning to severance pay, he quoted s. 40*a*(1)(*a*) (at p. 391) which includes the phrase "employees have their employment terminated by an employer". Austin J.A. concluded that this language limits the obligation to provide termination and severance pay to situations in which the employer terminates the employment. The operation of the *ESA*, he stated, is not triggered by the termination of employment resulting from an act of law such as bankruptcy.

14 In support of his conclusion, Austin J.A. reviewed the leading cases in this area of law. He cited *Re Malone Lynch Securities Ltd.*, [1972] 3 O.R. 725 (Ont. S.C.), wherein Houlden J. (as he then was) concluded that the *ESA* termination pay provisions were not designed to apply to a bankrupt employer. He also relied upon *Re Kemp Products Ltd.* (1978), 27 C.B.R. (N.S.) 1 (Ont. S.C.), for the proposition that the bankruptcy of a company at the instance of a creditor does not constitute dismissal. He concluded as follows at p. 395:

> The plain language of ss. 40 and 40*a* does not give rise to any liability to pay termination or severance pay except where the employment is terminated by the employer. In our case, the employment was terminated, not by the employer, but by the making of a receiving order against Rizzo on April 14, 1989, following a petition by one of its creditors. No entitlement to either termination or severance pay ever arose.

15 Regarding s. 7(5) of the *ESA*, Austin J.A. rejected the trial judge's interpretation and found that the section does not create a liability. Rather, in his opinion, it merely states when a liability otherwise created is to be paid and therefore it was not considered relevant to the issue before the court. Similarly, Austin J.A. did not accept the lower court's view of s. 2(3), the transitional provision in the *ESAA*. He found that that section had no effect upon the intention of the Legislature as evidenced by the terminology used in ss. 40 and 40*a*.

16 Austin J.A. concluded that, because the employment of Rizzo's former employees was terminated by the order of bankruptcy and not by the act of the employer, no liability arose with respect to termination, severance or vacation pay. The order of the trial judge was set aside and the Trustee's disallowance of the claims was restored.

4. Issues

17 This appeal raises one issue: does the termination of employment caused by the bankruptcy of an employer give rise to a claim provable in bankruptcy for termination pay and severance pay in accordance with the provisions of the *ESA*?

5. Analysis

18 The statutory obligation upon employers to provide both termination pay and severance pay is governed by ss. 40 and 40*a* of the *ESA*, respectively. The Court of Appeal noted that the plain language of those provisions suggests that termination pay and severance pay are payable only when the employer terminates the employment. For example, the

opening words of s. 40(1) are: "No employer shall terminate the employment of an employee...." Similarly, s. 40*a*(1) begins with the words, "Where...fifty or more employees have their employment terminated by an employer...." Therefore, the question on which this appeal turns is whether, when bankruptcy occurs, the employment can be said to be terminated "by the employer".

19 The Court of Appeal answered this question in the negative, holding that, where an employer is petitioned into bankruptcy by a creditor, the employment of its employees is not terminated "by the employer", but rather by operation of law. Thus, the Court of Appeal reasoned that, in the circumstances of the present case, the *ESA* termination pay and severance pay provisions were not applicable and no obligations arose. In answer, the appellants submit that the phrase "terminated by the employer" is best interpreted as reflecting a distinction between involuntary and voluntary termination of employment. It is their position that this language was intended to relieve employers of their obligation to pay termination and severance pay when employees leave their jobs voluntarily. However, the appellants maintain that where an employee's employment is involuntarily terminated by reason of their employer's bankruptcy, this constitutes termination "by the employer" for the purpose of triggering entitlement to termination and severance pay under the *ESA*.

20 At the heart of this conflict is an issue of statutory interpretation. Consistent with the findings of the Court of Appeal, the plain meaning of the words of the provisions here in question appears to restrict the obligation to pay termination and severance pay to those employers who have actively terminated the employment of their employees. At first blush, bankruptcy does not fit comfortably into this interpretation. However, with respect, I believe this analysis is incomplete.

21 Although much has been written about the interpretation of legislation (see, e.g., Ruth Sullivan, *Statutory Interpretation* (1997); Ruth Sullivan, *Driedger on the Construction of Statutes* (3rd ed. 1994) (hereinafter "*Construction of Statutes*"); Pierre-André Côté, *The Interpretation of Legislation in Canada* (2nd ed. 1991), Elmer Driedger in *Construction of Statutes* (2nd ed. 1983) best encapsulates the approach upon which I prefer to rely. He recognizes that statutory interpretation cannot be founded on the wording of the legislation alone. At p. 87 he states:

> 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.

Recent cases which have cited the above passage with approval include: *Canada (Procureure générale) c. Hydro-Québec*, (sub nom. *R. v. Hydro-Québec)* [1997] 3 S.C.R. 213 (S.C.C.); *Royal Bank v. Sparrow Electric Corp.*, [1997] 1 S.C.R. 411 (S.C.C.); *Verdun v. Toronto Dominion Bank*, [1996] 3 S.C.R. 550 (S.C.C.); *Friesen v. R.*, [1995] 3 S.C.R. 103 (S.C.C.).

22 I also rely upon s. 10 of the *Interpretation Act*, R.S.O. 1980, c. 219, which provides that every Act "shall be deemed to be remedial" and directs that every Act shall "receive such fair, large and liberal construction and interpretation as will best ensure the attainment of the object of the Act according to its true intent, meaning and spirit."

23 Although the Court of Appeal looked to the plain meaning of the specific provisions in question in the present case, with respect, I believe that the court did not pay sufficient attention to the scheme of the *ESA*, its object or the intention of the legislature; nor was the context of the words in issue appropriately recognized. I now turn to a discussion of these issues.

24 In *Machtinger v. HOJ Industries Ltd.*, [1992] 1 S.C.R. 986 (S.C.C.), at p. 1002, the majority of this Court recognized the importance that our society accords to employment and the fundamental role that it has assumed in the life of the individual. The manner in which employment can be terminated was said to be equally important (see also *Wallace v. United Grain Growers Ltd.* (1997), 219 N.R. 161 (S.C.C.). It was in this context that the majority in *Machtinger* described, at p. 1003, the object of the *ESA* as being the protection of "...the interests of employees by requiring employers to comply with certain minimum standards, including minimum periods of notice of termination." Accordingly, the majority concluded, at p. 1003, that, "...an interpretation of the Act which encourages employers to comply with the

minimum requirements of the Act, and so extends its protection to as many employees as possible, is to be favoured over one that does not."

25 The objects of the termination and severance pay provisions themselves are also broadly premised upon the need to protect employees. Section 40 of the *ESA* requires employers to give their employees reasonable notice of termination based upon length of service. One of the primary purposes of this notice period is to provide employees with an opportunity to take preparatory measures and seek alternative employment. It follows that s. 40(7)(a), which provides for termination pay in lieu of notice when an employer has failed to give the required statutory notice, is intended to "cushion" employees against the adverse effects of economic dislocation likely to follow from the absence of an opportunity to search for alternative employment. (Innis Christie, Geoffrey England and Brent Cotter, *Employment Law in Canada* (2nd ed. 1993), at pp. 572-81.

26 Similarly, s. 40*a*, which provides for severance pay, acts to compensate long-serving employees for their years of service and investment in the employer's business and for the special losses they suffer when their employment terminates. In *R. v. TNT Canada Inc.* (1996), 27 O.R. (3d) 546 (Ont. C.A.), Robins J.A. quoted with approval at pp. 556-57 from the words of D.D. Carter in the course of an employment standards determination in *Telegram Publishing Co. v. Zwelling* (1972), 1 L.A.C. (2d) 1 (Ont. Arb. Bd.), at p. 19, wherein he described the role of severance pay as follows:

> Severance pay recognizes that an employee does make an investment in his employer's business -- the extent of this investment being directly related to the length of the employee's service. This investment is the seniority that the employee builds up during his years of service....Upon termination of the employment relationship, this investment of years of service is lost, and the employee must start to rebuild seniority at another place of work. The severance pay, based on length of service, is some compensation for this loss of investment.

27 In my opinion, the consequences or effects which result from the Court of Appeal's interpretation of ss. 40 and 40*a* of the *ESA* are incompatible with both the object of the Act and with the object of the termination and severance pay provisions themselves. It is a well established principle of statutory interpretation that the legislature does not intend to produce absurd consequences. According to Côté, *supra*, an interpretation can be considered absurd if it leads to ridiculous or frivolous consequences, if it is extremely unreasonable or inequitable, if it is illogical or incoherent, or if it is incompatible with other provisions or with the object of the legislative enactment (at pp. 378-80). Sullivan echoes these comments noting that a label of absurdity can be attached to interpretations which defeat the purpose of a statute or render some aspect of it pointless or futile (Sullivan, *Construction of Statutes, supra*, at p. 88).

28 The trial judge properly noted that, if the *ESA* termination and severance pay provisions do not apply in circumstances of bankruptcy, those employees 'fortunate' enough to have been dismissed the day before a bankruptcy would be entitled to such payments, but those terminated on the day the bankruptcy becomes final would not be so entitled. In my view, the absurdity of this consequence is particularly evident in a unionized workplace where seniority is a factor in determining the order of lay-off. The more senior the employee, the larger the investment he or she has made in the employer and the greater the entitlement to termination and severance pay. However, it is the more senior personnel who are likely to be employed up until the time of the bankruptcy and who would thereby lose their entitlements to these payments.

29 If the Court of Appeal's interpretation of the termination and severance pay provisions is correct, it would be acceptable to distinguish between employees merely on the basis of the timing of their dismissal. It seems to me that such a result would arbitrarily deprive some employees of a means to cope with the economic dislocation caused by unemployment. In this way the protections of the *ESA* would be limited rather than extended, thereby defeating the intended working of the legislation. In my opinion, this is an unreasonable result.

30 In addition to the termination and severance pay provisions, both the appellants and the respondent relied upon various other sections of the *ESA* to advance their arguments regarding the intention of the legislature. In my view, although the majority of these sections offer little interpretive assistance, one transitional provision is particularly

instructive. In 1981, s. 2(1) of the *Employment Standards Amendment Act, 1981*, ("*ESAA*") introduced s.40*a*, the severance pay provision, to the *ESA*. Section 2(2) deemed that provision to come into force on January 1, 1981. Section 2(3), the transitional provision in question provided as follows:

> **2.** ...
>
> (3) Section 40*a* of the said Act does not apply to an employer who became bankrupt or an insolvent person within the meaning of the *Bankruptcy Act* (Canada) and whose assets have been distributed among his creditors or to an employer whose proposal within the meaning of the *Bankruptcy Act* (Canada) has been accepted by his creditors in the period from and including the 1st day of January, 1981, to and including the day immediately before the day this Act receives Royal Assent.

31 The Court of Appeal found that it was neither necessary nor appropriate to determine the intention of the legislature in enacting this provisional subsection. Nevertheless, the court took the position that the intention of the legislature as evidenced by the introductory words of ss. 40 and 40*a* was clear, namely, that termination by reason of a bankruptcy will not trigger the severance and termination pay obligations of the *ESA*. The court held that this intention remained unchanged by the introduction of the transitional provision. With respect, I do not agree with either of these findings. Firstly, in my opinion, the use of legislative history as a tool for determining the intention of the legislature is an entirely appropriate exercise and one which has often been employed by this Court (see, e.g., *R. v. Vasil*, [1981] 1 S.C.R. 469 (S.C.C.), at p. 487; *R. v. Paul*, [1982] 1 S.C.R. 621 (S.C.C.), at pp. 635, 653 and 660). Secondly, I believe that the transitional provision indicates that the Legislature intended that termination and severance pay obligations should arise upon an employers' bankruptcy.

32 In my view, by extending an exemption to employers who became bankrupt and lost control of their assets between the coming into force of the amendment and its receipt of royal assent, s. 2(3) necessarily implies that the severance pay obligation does in fact extend to bankrupt employers. It seems to me that, if this were not the case, no readily apparent purpose would be served by this transitional provision.

33 I find support for my conclusion in the decision of Saunders J. in *Royal Dressed Meats Inc.*, *supra*. Having reviewed s. 2(3) of the *ESAA*, he commented as follows:

> ...any doubt about the intention of the Ontario Legislature has been put to rest, in my opinion, by the transitional provision which introduced severance payments into the *ESA*...it seems to me an inescapable inference that the legislature intended liability for severance payments to arise on a bankruptcy. That intention would, in my opinion, extend to termination payments which are similar in character.

34 This interpretation is also consistent with statements made by the Minister of Labour at the time he introduced the 1981 amendments to the *ESA*. With regard to the new severance pay provision he stated:

> The circumstances surrounding a closure will govern the applicability of the severance pay legislation in some defined situations. For example, a bankrupt or insolvent firm will still be required to pay severance pay to employees to the extent that assets are available to satisfy their claims.
>
> .....
>
> ...the proposed severance pay measures will, as I indicated earlier, be retroactive to January 1 of this year. That retroactive provision, however, will not apply in those cases of bankruptcy and insolvency where the assets have already been distributed or where an agreement on a proposal to creditors has already been reached. [Ontario, Legislative Assembly, *Debates*, No. 36, at pp. 1236-37 (June 4, 1981)]

Moreover, in the legislative debates regarding the proposed amendments the Minister stated:

> For purposes of retroactivity, severance pay will not apply to bankruptcies under the Bankruptcy Act where assets have been distributed. However, once this Act receives royal assent, employees in bankruptcy closures will be covered by the severance pay provisions. [Ontario, Legislative Assembly, *Debates*, No. 48, at p. 1699 (June 16, 1981)]

35 Although the frailties of Hansard evidence are many, this Court has recognized that it can play a limited role in the interpretation of legislation. Writing for the Court in *R. v. Morgentaler*, [1993] 3 S.C.R. 463 (S.C.C.), at p. 484, Sopinka J. stated:

> ...until recently the courts have balked at admitting evidence of legislative debates and speeches....The main criticism of such evidence has been that it cannot represent the "intent" of the legislature, an incorporeal body, but that is equally true of other forms of legislative history. Provided that the court remains mindful of the limited reliability and weight of Hansard evidence, it should be admitted as relevant to both the background and the purpose of legislation.

36 Finally, with regard to the scheme of the legislation, since the *ESA* is a mechanism for providing minimum benefits and standards to protect the interests of employees, it can be characterized as benefits-conferring legislation. As such, according to several decisions of this Court, it ought to be interpreted in a broad and generous manner. Any doubt arising from difficulties of language should be resolved in favour of the claimant (see, e.g., *Abrahams v. Canada (Attorney General)*, [1983] 1 S.C.R. 2 (S.C.C.), at p. 10; *Hills v. Canada (Attorney General)*, [1988] 1 S.C.R. 513 (S.C.C.), at p. 537). It seems to me that, by limiting its analysis to the plain meaning of ss. 40 and 40*a* of the *ESA*, the Court of Appeal adopted an overly restrictive approach that is inconsistent with the scheme of the Act.

37 The Court of Appeal's reasons relied heavily upon the decision in *Malone Lynch, supra*. In *Malone Lynch*, Houlden J. held that s. 13, the group termination provision of the former *ESA*, R.S.O. 1970, c. 147, and the predecessor to s. 40 at issue in the present case, was not applicable where termination resulted from the bankruptcy of the employer. Section 13(2) of the *ESA* then in force provided that, if an employer wishes to terminate the employment of 50 or more employees, the employer must give notice of termination for the period prescribed in the regulations, "and until the expiry of such notice the terminations shall not take effect." Houlden J. reasoned that termination of employment through bankruptcy could not trigger the termination payment provision, as employees in this situation had not received the written notice required by the statute, and therefore could not be said to have been terminated in accordance with the Act.

38 Two years after *Malone Lynch* was decided, the 1970 *ESA* termination pay provisions were amended by the *Employment Standards Act, 1974*, S.O. 1974, c. 112. As amended, s. 40(7) of the 1974 *ESA* eliminated the requirement that notice be given before termination can take effect. This provision makes it clear that termination pay is owing where an employer fails to give notice of termination and that employment terminates irrespective of whether or not proper notice has been given. Therefore, in my opinion it is clear that the *Malone Lynch* decision turned on statutory provisions which are materially different from those applicable in the instant case. It seems to me that Houlden J.'s holding goes no further than to say that the provisions of the 1970 *ESA* have no application to a bankrupt employer. For this reason, I do not accept the *Malone Lynch* decision as persuasive authority for the Court of Appeal's findings. I note that the courts in *Royal Dressed Meats, supra*, and *British Columbia (Director of Employment Standards) v. Eland Distributors Ltd. (Trustee of)* (1996), 40 C.B.R. (3d) 25 (B.C. S.C.), declined to rely upon *Malone Lynch* based upon similar reasoning.

39 The Court of Appeal also relied upon *Re Kemp Products Ltd., supra*, for the proposition that although the employment relationship will terminate upon an employer's bankruptcy, this does not constitute a "dismissal". I note that this case did not arise under the provisions of the *ESA*. Rather, it turned on the interpretation of the term "dismissal" in what the complainant alleged to be an employment contract. As such, I do not accept it as authoritative jurisprudence in the circumstances of this case. For the reasons discussed above, I also disagree with the Court of Appeal's reliance on *Mills-Hughes v. Raynor* (1988), 63 O.R. (2d) 343 (Ont. C.A.), which cited the decision in *Malone Lynch, supra* with approval.

40 As I see the matter, when the express words of ss. 40 and 40*a* of the *ESA* are examined in their entire context, there is ample support for the conclusion that the words "terminated by the employer" must be interpreted to include termination resulting from the bankruptcy of the employer. Using the broad and generous approach to interpretation appropriate for benefits-conferring legislation, I believe that these words can reasonably bear that construction (see *R. v. Z. (D.A.)*, [1992] 2 S.C.R. 1025 (S.C.C.)). I also note that the intention of the Legislature as evidenced in s. 2(3) of the *ESSA*, clearly favours this interpretation. Further, in my opinion, to deny employees the right to claim *ESA* termination and severance pay where their termination has resulted from their employer's bankruptcy, would be inconsistent with the purpose of the termination and severance pay provisions and would undermine the object of the *ESA*, namely, to protect the interests of as many employees as possible.

41 In my view, the impetus behind the termination of employment has no bearing upon the ability of the dismissed employee to cope with the sudden economic dislocation caused by unemployment. As all dismissed employees are equally in need of the protections provided by the *ESA*, any distinction between employees whose termination resulted from the bankruptcy of their employer and those who have been terminated for some other reason would be arbitrary and inequitable. Further, I believe that such an interpretation would defeat the true meaning, intent and spirit of the *ESA*. Therefore, I conclude that termination as a result of an employer's bankruptcy does give rise to an unsecured claim provable in bankruptcy pursuant to s. 121 of the *BA* for termination and severance pay in accordance with ss. 40 and 40*a* of the *ESA*. Because of this conclusion, I do not find it necessary to address the alternative finding of the trial judge as to the applicability of s. 7(5) of the *ESA*.

42 I note that subsequent to the Rizzo bankruptcy, the termination and severance pay provisions of the *ESA* underwent another amendment. Sections 74(1) and 75(1) of the *Labour Relations and Employment Statute Law Amendment Act, 1995*, S.O. 1995, c. 1, amend those provisions so that they now expressly provide that where employment is terminated by operation of law as a result of the bankruptcy of the employer, the employer will be deemed to have terminated the employment. However, s. 17 of the *Interpretation Act* directs that, "the repeal or amendment of an Act shall be deemed not to be or to involve any declaration as to the previous state of the law." As a result, I note that the subsequent change in the legislation has played no role in determining the present appeal.

6. Disposition and Costs

43 I would allow the appeal and set aside paragraph 1 of the order of the Court of Appeal. In lieu thereof, I would substitute an order declaring that Rizzo's former employees are entitled to make claims for termination pay (including vacation pay due thereon) and severance pay as unsecured creditors. As to costs, the Ministry of Labour led no evidence regarding what effort it made in notifying or securing the consent of the Rizzo employees before it discontinued its application for leave to appeal to this Court on their behalf. In light of these circumstances, I would order that the costs in this Court be paid to the appellant by the Ministry on a party-and-party basis. I would not disturb the orders of the courts below with respect to costs.

Appeal allowed.

Pourvoi accueilli.

TAB 11

2008 CarswellOnt 6759
Ontario Superior Court of Justice (Divisional Court)

Mascia v. Dixie X-Ray Associates Ltd.

2008 CarswellOnt 6759, [2008] O.J. No. 4554, 170 A.C.W.S. (3d) 756, 55 B.L.R. (4th) 186

Anthony Mascia & Northern Magnetic Corporation v. Dixie X-Ray Associates Limited, Cedarwood Management and Financial Consultants Inc., Cirrus Management Incorporated, Karing Management Limited, Sadara Management Corporation, Daniel Slipacoff, Allan Yee, Kwan Cheung Tsui, Isadore Czosniak, Ron Polson and Soe Lwin Kyone

Cunningham A.C.J. Ont. S.C.J., Carnwath, Bellamy JJ.

Heard: November 12, 2008
Judgment: November 17, 2008
Docket: Toronto 211-08

Proceedings: reversing *Mascia v. Dixie X-Ray Associates Ltd.* (2008), 2008 CarswellOnt 1624 (Ont. S.C.J.); additional reasons at *Mascia v. Dixie X-Ray Associates Ltd.* (2009), 2009 CarswellOnt 72 (Ont. Div. Ct.)

Counsel: Barry H. Bresner, Markus Kremer for Respondents / Appellants, Dixie et al.
Lisa S. Corne for Applicants / Cross-Appellants, Anthony Mascia, Northern Magnetic Corporation

Subject: Corporate and Commercial; Civil Practice and Procedure

Headnote

Business associations --- Specific corporate organization matters — Shareholders — Shareholder agreements — General principles

Penalty clause — N was shareholder of company — Company provided professional services to hospital — M was N's principal shareholder and radiologist at hospital — Section 21 of agreement permitted majority shareholders to require shareholder to sell all of its shares at any time — Other shareholders of company exercised their rights under s. 21 of agreement and acquired N's shares in company — Section 21(d) of agreement required that on closing date, selling shareholder must resign position at hospital or purchase price of seller's shares would be reduced to 25 per cent of original value — M did not resign — M and N brought application for relief from oppression under s. 248 of Business Corporations Act — Application dismissed — Application judge found that last portion of s. 21(d) of shareholders' agreement was unenforceable penalty clause — Company and other shareholders appealed — Appeal allowed — Interpretation of s. 21(d) was question of pure law and standard of review was correctness — Application judge should have started with proposition that s. 21(d) was prima facie enforceable and that there was presumption that s. 21(d) was genuine pre-estimate of damages — Onus to displace presumption rested with M — M adduced no evidence to prove that section was penalty or that it was unenforceable — It was error by application judge to misplace onus and to have assumed that reduction in purchase price was greater than company's losses — There was nothing unconscionable in holding M to bargain he voluntarily made when he signed shareholders agreement — Section 21 did not prohibit M from working at hospital or anywhere else but simply imposed reasonable economic consequence for doing so by offsetting loss of income that company would suffer — It was within M's power to avoid reduction by resigning from hospital.

Business associations --- Specific corporate organization matters — Shareholders — Shareholders' remedies — Relief from oppression — Miscellaneous issues

N was shareholder of company — Company provided range of diagnostic imaging services and provided professional services to hospital — M was N's principal shareholder and radiologist at hospital — Section 21 of agreement permitted majority shareholders to require shareholder to sell all of its shares at any time — Other shareholders of company exercised their rights under s. 21 of agreement and acquired N's shares in company — Section 21(d) of agreement required that on closing date, selling shareholder must resign as radiologist or any other position he held at hospital and if he failed to do so, purchase price of seller's shares would be reduced to 25 per cent of original value — M did not resign — M and N brought application for relief from oppression under s. 248 of Business Corporations Act — Application dismissed — Application judge held that there was no oppression — M and N appealed — Appeal dismissed — Burden of proof was on M — Company was not required to prove that it did not act oppressively — Application judge examined affidavits and analyzed each issue with respect to whether any conflicting evidence was material to her conclusion and whether any discrepancy made it necessary for any part of application to proceed to trial — Application judge correctly considered reasonable expectations of shareholder parties — Application judge correctly found that there was no oppression based on evidence that books and records were open to M, financial information was provided to M in timely manner, valuation was fair and expenses were not untoward.

Civil practice and procedure --- Practice on appeal — Powers and duties of appellate court — Evidence on appeal — New evidence

N was shareholder of company — Company provided range of diagnostic imaging services and provided professional services to hospital — M was N's principal shareholder and radiologist at hospital — Section 21 of agreement permitted majority shareholders to require shareholder to sell all of its shares at any time — Other shareholders of company exercised their rights under s. 21 of agreement and acquired N's shares in company — Section 21(d) of agreement required that on closing date, selling shareholder must resign as radiologist or any other position he held at hospital and if he failed to do so, purchase price of seller's shares would be reduced to 25 per cent of original value — M did not resign — M and N brought application for relief from oppression under s. 248 of Business Corporations Act — Application dismissed — Application judge held that there was no oppression — M and N appealed — M brought motion for order permitting introduction of fresh evidence — Motion dismissed — There was no new evidence — No evidence was entered to support M's allegations — Interests of justice did not call for admission of fresh evidence and it was not required to determine whether business affairs of company were carried out in oppressive manner.

Table of Authorities

Cases considered:

Housen v. Nikolaisen (2002), 10 C.C.L.T. (3d) 157, 211 D.L.R. (4th) 577, 286 N.R. 1, [2002] 7 W.W.R. 1, 2002 CarswellSask 178, 2002 CarswellSask 179, 2002 SCC 33, 30 M.P.L.R. (3d) 1, 219 Sask. R. 1, 272 W.A.C. 1, [2002] 2 S.C.R. 235 (S.C.C.) — followed

Infinite Maintenance Systems Ltd. v. ORC Management Ltd. (2001), 139 O.A.C. 331, 5 C.P.C. (5th) 241, 2001 C.L.L.C. 210-021, 2001 CarswellOnt 59 (Ont. C.A.) — considered

Kabutey v. New-Form Manufacturing Co. (1999), 1999 CarswellOnt 3057, 49 C.C.E.L. (2d) 252 (Ont. S.C.J.) — considered

L. (H.) v. Canada (Attorney General) (2005), 2005 SCC 25, 2005 CarswellSask 268, 2005 CarswellSask 273, 333 N.R. 1, 8 C.P.C. (6th) 199, 24 Admin. L.R. (4th) 1, 262 Sask. R. 1, 347 W.A.C. 1, [2005] 8 W.W.R. 1, 29 C.C.L.T. (3d) 1, 251 D.L.R. (4th) 604, [2005] 1 S.C.R. 401 (S.C.C.) — considered

R. v. Palmer (1979), 1979 CarswellBC 533, 1979 CarswellBC 541, [1980] 1 S.C.R. 759, 30 N.R. 181, 14 C.R. (3d) 22, 17 C.R. (3d) 34 (Fr.), 50 C.C.C. (2d) 193, 106 D.L.R. (3d) 212 (S.C.C.) — followed

Tomaszewska v. College of Nurses (Ontario) (2007), 2007 CarswellOnt 2760, 226 O.A.C. 177 (Ont. Div. Ct.) — referred to

Statutes considered:

Business Corporations Act, R.S.O. 1990, c. B.16
Generally — referred to

s. 248 — referred to

Rules considered:

Rules of Civil Procedure, R.R.O. 1990, Reg. 194
R. 62.02 — referred to

APPEAL and CROSS APPEAL from judgment reported at *Mascia v. Dixie X-Ray Associates Ltd.* (2008), 2008 CarswellOnt 1624, 55 B.L.R. (4th) 163 (Ont. S.C.J.), dismissing application for relief for oppression under *Business Corporations Act*.

***Per curiam*:**

1 This is an appeal and cross-appeal from a decision of Madam Justice A. Hoy dated March 25, 2008.

2 Dixie et al. ("Dixie") appeal the finding that the last sentence of section 21(d) of the shareholders agreement was an unenforceable penalty clause. Dr. Anthony Mascia and Northern Magnetic Corporation ("Dr. Mascia") cross-appeal the denial of a request for an adjournment, the refusal to grant an order directing that the application proceed to trial, and the finding that there had been no oppression.

3 For reasons that follow, the appeal is allowed and the cross-appeal is dismissed.

The Appeal

4 Justice Hoy concluded that the last sentence of section 21(d) of the shareholders agreement was unenforceable because it was a penalty and that "it would be unconscionable or seriously unfair, in the circumstances of this case, at the time when the clause is relied on, to enforce the clause as written." In the appellants' favour, she concluded that Dixie was entitled to conduct the forced buy-out of Northern's shares, that Dr. Mascia was in breach of the shareholders agreement for failing to resign, that Dixie was entitled to recover provable damages for the breach, and that there was no oppression within the meaning of the Ontario *Business Corporations Act*.

5 There were no facts in dispute about the content of the section in the shareholders agreement or the circumstances under which Dr. Mascia agreed to it. The only question was one of interpreting the section in relation to the law regarding penalty clauses.

6 Dixie submits that the standard of review for a question of law is correctness. Dr. Mascia submits that the setting aside of the section was based upon the exercise of Justice Hoy's discretion which emanated from her power to grant an equitable remedy against a penalty. As such, it must be shown that the discretion was exercised arbitrarily or capriciously, or was based upon a wrong or inapplicable principle of law rendering her conclusion clearly wrong.

7 The decision with respect to the interpretation of the last sentence of section 21(d) of the shareholders agreement is a question of pure law and the standard of review is one of correctness. The Supreme Court of Canada most recently addressed the standard of review of an appeal from a judge's decision in *Housen v. Nikolaisen* (2002), 211 D.L.R. (4th) 577 (S.C.C.), at para. 8:

> On a pure question of law, the basic rule with respect to the review of a trial judge's findings is that an appellate court is free to replace the opinion of the trial judge with its own. Thus the standard of review on a question of law is that of correctness.

8 The onus of proving that a clause is a penalty lies with the party alleging the clause is a penalty. That party must prove that the clause is a penalty with regard to the circumstances at the time of formation. Then, if the clause is found to be a penalty, the party must prove that enforcement would be unconscionable at the time it is invoked, that is, that the penalty is "extravagant and exorbitant in comparison with the greatest loss which could conceivably have flowed from the breach": *Infinite Maintenance Systems Ltd. v. ORC Management Ltd.*, [2001] O.J. No. 77 (Ont. C.A.), para. 13.

9 In our view, the application judge should have started with the proposition that the section was *prima facie* enforceable and that there was a presumption that the section was a genuine pre-estimate of damages. The onus to displace that presumption rested with Dr. Mascia. He, not Dixie, was the one who was required to demonstrate that the last sentence of section 21(d) did not represent a genuine pre-estimate of damages at the time he entered into the shareholders agreement and, further, that it would be unconscionable to apply the last sentence of section 21(d) on the facts of this case.

10 Dr. Mascia adduced no evidence to prove that the section was either a penalty or that it should be unenforceable. He also failed to prove either that the reduction in the purchase price required by section 21(d) was not a genuine pre-estimate of damages or that its enforcement would be unconscionable.

11 While not required to do so, Dixie did present evidence in support of the presumption that the section was an enforceable clause for liquidated damages. Its evidence was uncontested and established that Dixie's loss in income resulting from Dr. Mascia's decision to remain at Humber River Regional Hospital ("HRRH") was approximately $400,000 per year resulting in $1.2 million for the three years during which the agreement prohibited him from working at HRRH.

12 The application judge appears to have reversed the onus and to have placed it on Dixie instead of on Dr. Mascia. It was an error for the application judge to have misplaced this onus and to have assumed that the reduction in the purchase price was greater than Dixie's losses.

13 Further, even if Dr. Mascia had discharged his onus, the section would still have been enforceable unless he could prove that applying the clause would be unconscionable in the circumstances of this case. Hoy, J. did find that Dixie's actions were not oppressive within the meaning of s.248 of the Ontario *Business Corporations Act*; yet she provided no reasons for her conclusion that "it would be unconscionable or seriously unfair" to enforce the section as written.

14 Generally, courts will not interfere with an agreement made by sophisticated parties acting at arms' length and, in particular, will not set aside a shareholders agreement "that has been entered into in good faith by experienced persons who have had independent legal advice": *Kabutey v. New-Form Manufacturing Co.*, [1999] O.J. No. 3635 (Ont. S.C.J.), at para. 12. Where parties have agreed upon a formula for determining the price at which departing shareholders will be bought out of a company, the expectation is that they will live with that formula.

15 When he entered into the shareholders agreement, Dr. Mascia had the benefit of both independent legal advice as well as independent financial advice. He negotiated the terms on which he was prepared to invest in Dixie. The evidence disclosed that without the protection afforded by the section, the price paid by Dr. Mascia and the six other Dixie

shareholders may well have been less, to reflect the anticipated losses that would result if departing shareholders were free to continue to compete for work at HRRH with Dixie's radiologists.

16 There was nothing unconscionable in holding Dr. Mascia to the bargain he voluntarily made when he signed the shareholders agreement, an agreement that applied equally to all seven shareholders, each of whom would also be bound by the section. Indeed, in our view, it would be inequitable for the Dixie shareholders who had the value of their shares protected while they were shareholders to now deny that same protection to Dixie's remaining shareholders, each of whom bought their shares at a value which presumably reflected their position.

17 The section neither prohibited Dr. Mascia from continuing to work at HRRH nor anywhere else. It simply imposed a reasonable economic consequence for doing so by offsetting a loss of income that Dixie would suffer as a result of Dr. Mascia continuing to practice at HRRH in direct competition with Dixie. It was entirely within his power to avoid the reduction by resigning from HRRH.

18 In the result, the appeal is allowed and paragraph 2 of the judgment is overturned. The ultimate result of this decision, and what follows, is that Dr. Mascia's application is dismissed in its entirety.

The Cross-Appeal

19 For reasons given at the hearing of the cross-appeal, the cross-appeal to set aside paragraph 1 of the judgment was dismissed. We concluded that the motion for an order adjourning the application and converting it to an action was an interlocutory motion which required leave to appeal pursuant to Rule 62.02 of the Rules of Civil Procedure. Leave to appeal had not been sought.

20 Dr. Mascia also cross-appealed paragraph 3 of the judgment whereby Hoy, J. dismissed the balance of the oppression application under section 248 of the Ontario Business Corporations Act. Citing twenty-six grounds of appeal, Dr. Mascia sought an order directing that the application be converted into an action and proceed to trial on certain terms.

21 Dr. Mascia has not specifically addressed the standard of review to be applied on his cross-appeal.

22 In *Housen (supra)*, the Court held that the standard of review of a judge's findings on a question of law is correctness, while a judge's findings of fact can be reversed only if the judge's decision evidences a "palpable and overriding error." This statement has been interpreted as requiring a decision to be "clearly wrong" in the sense of being "not reasonably supported by the evidence": *L. (H.) v. Canada (Attorney General)*, [2005] 1 S.C.R. 401 (S.C.C.) at para. 110. Justice Hoy's findings of fact cannot be reversed unless she made a palpable and overriding error. We see no such error.

23 To the extent that Hoy, J. formulated the legal test for deciding whether there was oppression, the test is one of correctness. Again, we see no error that would require us to substitute our own conclusion.

24 This was an oppression application. In such an application, the burden of proof rests on the party seeking relief which, in this case, was Dr. Mascia. Dixie was not required to prove that it did not act oppressively.

25 Justice Hoy carefully reviewed all the affidavit material and the exhibits before her. It is true that she was presented with conflicting affidavits. That was because the parties elected not to cross-examine on the affidavits. In particular, Dr. Mascia chose to proceed by way of an application; he chose not to cross-examine any witnesses on their affidavits; he chose not to provide any evidence other than his own; and he chose not to call anyone from Ernst & Young. Dr. Mascia was bound by those choices.

26 Justice Hoy vigilantly examined the affidavits and analyzed each issue with respect to whether any conflicting evidence was material to her conclusion and whether any discrepancy made it necessary for any part of the application to proceed to trial to determine the issue. Repeatedly, she reviewed each inconsistency in the context of the legal issue

requiring determination. In every case, after thoughtful analysis, Hoy, J. concluded that the conflicting evidence was not material to the facts in dispute and did not make it necessary to proceed to trial.

27 Throughout, Justice Hoy correctly considered the reasonable expectations of the shareholder parties. Having considered the evidence that the books and records were open to Dr. Mascia, that financial information was provided to him and his accountants on request and in a timely manner, that there was nothing untoward in the manner in which expenses were charged to Dixie, that the 2006 valuation was fair, and that Dr. Mascia's allegations were fully answered by Dixie's evidence, Justice Hoy correctly found no oppression. We see no reason to interfere with her conclusions.

Motion for Fresh Evidence

28 Dr. Mascia brought a motion for an order permitting the introduction of fresh evidence on the appeal and the cross-appeal. The fresh evidence consisted of two affidavits from Dr. Mascia and one from an accountant at Ernst & Young LLP. In bringing this motion, he argued that this is new information that came to him only after the release of Justice Hoy's decision and that it is necessary in order to deal fairly with the issues on the appeal. Declining to admit this fresh evidence, argued Dr. Mascia, would lead to a substantial injustice.

29 Having permitted the late filing of a considerable amount of material, and having heard lengthy argument on this matter, we dismiss this motion despite the able submissions of Ms. Corne.

30 There was, in fact, no new evidence. At most, Dr. Mascia made many new allegations of wrongdoing, some of them criminal in nature. He then summonsed certain individuals for examination because they would neither repeat their allegations nor would they provide affidavits in support of his motion for fresh evidence. Much of what he alleges was based on rumour, speculation and unfounded allegations; no evidence was put before us that would prove the allegations he made. To the contrary, Dixie's countering affidavit evidence and, in particular, the supporting materials, disprove the allegations.

31 The Court has the discretion to admit fresh evidence. The test for such admission is set out in *R. v. Palmer* (1979), [1980] 1 S.C.R. 759 (S.C.C.) and was recently discussed by this Court in *Tomaszewska v. College of Nurses (Ontario)*, [2007] O.J. No. 1731 (Ont. Div. Ct.) at para. 8. We find that the material Dr. Mascia seeks to introduce as fresh evidence does not meet the test for the introduction of fresh evidence, nor is this a case where the interests of justice call for the admission of the fresh evidence. It is not required to determine whether the business affairs of Dixie were carried out in a way that were oppressive or to determine whether any of Dr. Mascia's interests were unfairly disregarded or prejudiced.

Motion to Strike Allegations and an affidavit

32 Dixie moved to strike paragraph 22 of Dr. Mascia's affidavit and to strike out the affidavit of Ms. Corne's articling student. Ms. Corne quite properly agreed to withdraw both of these, so they are no longer before us.

Motion to Quash

33 Dixie brought a motion to quash three summonses issued under Rule 39 on behalf of Dr. Mascia. Given our decision with respect to the cross-appeal, this motion is moot. Had it not been moot, we would have granted the motion on the basis that finality was required and it was improper to examine witnesses at this stage of the proceeding for the collateral purpose of seeking to obtain new evidence.

Costs

34 If the parties cannot agree on the costs of these appeals and motions, Dixie may make brief written submissions within ten days of the release of this decision. Dr. Mascia will have five days to reply. All submissions are to be made through the Divisional Court office.

Appeal allowed; cross appeal dismissed.

End of Document

TAB 12

2004 BCCA 270
British Columbia Court of Appeal

MacMillan v. Kaiser Equipment Ltd.

2004 CarswellBC 1066, 2004 BCCA 270, [2004] B.C.W.L.D. 790, [2004] B.C.J. No. 969, 131 A.C.W.S. (3d) 77, 196 B.C.A.C. 117, 322 W.A.C. 117, 33 B.C.L.R. (4th) 44

Donald Mark MacMillan (Appellant / Plaintiff) and Kaiser Equipment Ltd., Kaiser International Developments Ltd., LFD Industries Ltd., Yee Bun Lee, Alfred Po-Hong Ma, Axia Incorporated and Ames Taping Tool Systems Company (Respondents / Defendants)

Donald, Saunders, Oppal JJ.A.

Heard: February 16-17, 2004
Judgment: May 14, 2004
Docket: Vancouver CA030870

Proceedings: affirming *MacMillan v. Kaiser Equipment Ltd.* (2003), 2003 BCSC 672, 2003 CarswellBC 1023 (B.C. S.C.)

Counsel: C.S. Wilson for Appellant
R.P. Attisha for Respondents, Kaiser Equipment Ltd., Kaiser International Developments Ltd., LFD Industries Ltd., Y.B. Lee, A.P. Ma
D.M. Bain for Respondents, Axia Inc., Ames Taping Tool Systems Co.

Subject: Contracts; Evidence; Corporate and Commercial; Torts; Civil Practice and Procedure; Property

Headnote

Contracts --- Construction and interpretation — Words and phrases — General principles

M was inventor of tools for use in drywalling industry — In 1990, M's company C Co. was bought by defendants and M was put under contract as consultant — In November 1995, M and defendant entered into employment agreement pursuant to which M agreed to serve as C Co.'s vice-president of operations — On October 1, 1996, defendant and M signed so-called draft agreement in principle which was meant to be additional or supplementary to 1995 employment agreement and subject to latter's conditions — Draft agreement in principle allegedly promised to deliver to M shares in C Co. — On February 27, 1997, C Co. terminated M's employment, alleging cause — M brought action in small claims court against defendants, alleging negligent misrepresentation and breach of contract — Action summarily dismissed — M appealed — Appeal dismissed — Trial judge did not err in summarily dismissing M's claims — Trial judge did not err in concluding that entire agreement clause in 1995 employment agreement was not rebutted or modified by collateral promise of shares — Entire agreement clause in 1995 employment agreement ruled out any argument by M with respect to collateral promise of shares — Trial judge did not err in finding that 1996 draft agreement in principle was not enforceable — No firm agreement between parties relating to transfer of shares to M — Trial judge did not make palpable and overriding error in coming to factual conclusions based on accepted facts.

Evidence --- Parol evidence rule — Collateral agreements — General

M was inventor of tools for use in drywalling industry — In 1990, M's company C Co. was bought by defendants and M was put under contract as consultant — In November 1995, M and defendant entered into employment agreement pursuant to which M agreed to serve as C Co.'s vice-president of operations — On October 1, 1996, defendant and M signed so-called draft agreement in principle which was meant to be additional or supplementary

to 1995 employment agreement and subject to latter's conditions — Draft agreement in principle allegedly promised to deliver to M shares in C Co. — On February 27, 1997, C Co. terminated M's employment, alleging cause — M brought action in small claims court against defendants, alleging negligent misrepresentation and breach of contract — Action summarily dismissed — M appealed — Appeal dismissed — Trial judge did not err in summarily dismissing M's claims — Trial judge did not err in concluding that entire agreement clause in 1995 employment agreement was not rebutted or modified by collateral promise of shares — Entire agreement clause in 1995 employment agreement ruled out any argument by M with respect to collateral promise of shares — Trial judge did not err in finding that 1996 draft agreement in principle was not enforceable — No firm agreement between parties relating to transfer of shares to M — Trial judge did not make palpable and overriding error in coming to factual conclusions based on accepted facts.

Fraud and misrepresentation --- Negligent misrepresentation (Hedley Byrne principle) — Miscellaneous issues

M was inventor of tools for use in drywalling industry — In 1990, M's company C Co. was bought by defendants and M was put under contract as consultant — In November 1995, M and defendant entered into employment agreement pursuant to which M agreed to serve as C Co.'s vice-president of operations — On October 1, 1996, defendant and M signed so-called draft agreement in principle which was meant to be additional or supplementary to 1995 employment agreement and subject to latter's conditions — Draft agreement in principle allegedly promised to deliver to M shares in C Co. — On February 27, 1997, C Co. terminated M's employment, alleging cause — M brought action in small claims court against defendants, alleging negligent misrepresentation and breach of contract — Action summarily dismissed — M appealed — Appeal dismissed — Trial judge did not err in summarily dismissing M's claims — Trial judge did not err in concluding that entire agreement clause in 1995 employment agreement was not rebutted or modified by collateral promise of shares — Entire agreement clause in 1995 employment agreement ruled out any argument by M with respect to collateral promise of shares — Trial judge did not err in finding that 1996 draft agreement in principle was not enforceable — No firm agreement between parties relating to transfer of shares to M — Trial judge did not make palpable and overriding error in coming to factual conclusions based on accepted facts.

Civil practice and procedure --- Pleadings — General requirements — Where constituting abuse of process

M was inventor of tools for use in drywalling industry — In 1990, M's company C Co. was bought by defendants and M was put under contract as consultant — In November 1995, M and defendant entered into employment agreement pursuant to which M agreed to serve as C Co.'s vice-president of operations — On October 1, 1996, defendant and M signed so-called draft agreement in principle which was meant to be additional or supplementary to 1995 employment agreement and subject to latter's conditions — Draft agreement in principle allegedly promised to deliver to M shares in C Co. — On February 27, 1997, C Co. terminated M's employment, alleging cause — M brought action in small claims court against defendants, alleging negligent misrepresentation and breach of contract — Action summarily dismissed — M appealed — Appeal dismissed — Trial judge did not err in summarily dismissing M's claims — Trial judge did not err in concluding that entire agreement clause in 1995 employment agreement was not rebutted or modified by collateral promise of shares — Entire agreement clause in 1995 employment agreement ruled out any argument by M with respect to collateral promise of shares — Trial judge did not err in finding that 1996 draft agreement in principle was not enforceable — No firm agreement between parties relating to transfer of shares to M — Trial judge did not make palpable and overriding error in coming to factual conclusions based on accepted facts.

Table of Authorities

Cases considered by *Oppal J.A.*:

Gutierrez v. Tropic International Ltd. (2002), 2002 CarswellOnt 2599, 162 O.A.C. 247, 63 O.R. (3d) 63, 33 B.L.R. (3d) 18 (Ont. C.A.) — considered

Hawrish v. Bank of Montreal (1969), [1969] S.C.R. 515, 2 D.L.R. (3d) 600, 66 W.W.R. 673, 1969 CarswellSask 9 (S.C.C.) — considered

Housen v. Nikolaisen (2002), 2002 SCC 33, 2002 CarswellSask 178, 2002 CarswellSask 179, 286 N.R. 1, 10 C.C.L.T. (3d) 157, 211 D.L.R. (4th) 577, [2002] 7 W.W.R. 1, 219 Sask. R. 1, 272 W.A.C. 1, 30 M.P.L.R. (3d) 1, [2002] 2 S.C.R. 235 (S.C.C.) — followed

Inspiration Management Ltd. v. McDermid St. Lawrence Ltd. (1989), 36 B.C.L.R. (2d) 202, 36 C.P.C. (2d) 199, 1989 CarswellBC 69 (B.C. C.A.) — considered

Orangeville Raceway Ltd. v. Wood Gundy Inc. (1995), 6 B.C.L.R. (3d) 391, 40 C.P.C. (3d) 226, 59 B.C.A.C. 241, 98 W.A.C. 241, 1995 CarswellBC 274 (B.C. C.A.) — considered

Placer Development Ltd. v. Skyline Explorations Ltd. (1985), 67 B.C.L.R. 366, 1985 CarswellBC 336 (B.C. C.A.) — considered

Power Consolidated (China) Pulp Inc. v. British Columbia Resources Investment Corp. (1988), 19 C.P.C. (3d) 396, 1988 CarswellBC 615 (B.C. C.A.) — considered

Turner v. Visscher Holdings Inc. (1996), 23 B.C.L.R. (3d) 303, 77 B.C.A.C. 48, 126 W.A.C. 48, 1996 CarswellBC 1052 (B.C. C.A.) — distinguished

Zippy Print Enterprises Ltd. v. Pawliuk (1994), 100 B.C.L.R. (2d) 55, [1995] 3 W.W.R. 324, 20 B.L.R. (2d) 170, 1994 CarswellBC 4 (B.C. C.A.) — distinguished

Rules considered:

Rules of Court, 1990, B.C. Reg. 221/90
R. 18A — referred to

APPEAL by plaintiff of judgment reported at *MacMillan v. Kaiser Equipment Ltd.* (2003), 2003 BCSC 672, 2003 CarswellBC 1023 (B.C. S.C.), dismissing action in negligent misrepresentation and breach of contract.

***Oppal J.A.*:**

INTRODUCTION

1 After a five-day summary trial held under Rule 18A of the *Rules of Court*, Allan J. dismissed the action of the appellant, Donald Mark MacMillan, for negligent misrepresentation, breach of contract, inducing breach of contract and unjust enrichment. The neutral citation of her reasons for judgment is 2003 BCSC 672 (B.C. S.C.).

2 In this appeal Mr. MacMillan has raised the following grounds:

1. whether the trial judge erred in proceeding under Rule 18A of the *Rules of Court*;

2. whether the trial judge erred in concluding that the entire agreement clause in a written contract was not rebutted or modified by a collateral agreement; and

3. whether the trial judge erred in finding that a draft agreement made in 1996 was not enforceable.

BACKGROUND

3 Mr. MacMillan is an inventor of tools for use in the drywalling industry. In 1990 and 1991, through Concorde Tool Corporation ("Concorde"), Mr. MacMillan applied for patents for five inventions. One such patent, for an adjustable length handle, proved to be quite valuable. Prior to 13 June 1990 all outstanding shares in Concorde were owned by Mr. MacMillan and Raymond Bernier.

4 In 1990, the respondents Yee Bun Lee and David Fung, as well as one David Dick, incorporated the respondent LFD Industries Ltd. ("LFD"). Mr. Lee, through the respondent Kaiser International Developments Ltd. ("Kaiser"), owned 60% of the outstanding shares of LFD. Mr. Fung, through ACDEG International Ltd. ("ACDEG") held 20%. Mr. Dick personally held the remaining 20% of LFD's shares.

5 In June 1990, the parties entered into two agreements. The first was a share purchase agreement (the "1990 Share Purchase Agreement") between Concorde, LFD and Messrs. MacMillan and Bernier. Under its terms, LFD purchased all outstanding shares in Concorde and Concorde assigned to LFD all intellectual property that it held and used. The 1990 Share Purchase Agreement contained a so-called "entire agreement" clause which read as follows:

> 10.4 Whole Agreement. This Agreement contains the whole agreement between the Vendors and the Purchaser in respect of the purchase and sale contemplated hereby and there are no warranties, representations, terms, conditions or collateral agreements, express or implied, or otherwise other than expressly set forth in this Agreement.

6 The second agreement made was a consulting agreement (the "1990 Consulting Agreement") between Mr. MacMillan and Concorde, the execution of which was required under the 1990 Share Purchase Agreement. The 1990 Consulting Agreement was essentially an employment contract under which Mr. MacMillan would be an independent contractor. It provided that Mr. MacMillan would disclose to Concorde "all designs, rights to sell patents or patentable concepts", stipulated that the patents would be the property of Concorde and required that Mr. MacMillan not claim any interest in them. Like the 1990 Share Purchase Agreement, the 1990 Consulting Agreement contained an entire agreement clause.

7 The 1990 Consulting Agreement was for a four-year term commencing 15 June 1990. Mr. MacMillan alleges that around the time the 1990 Consulting Agreement terminated in 1994 certain events occurred that lie at the heart of the dispute between the parties in this appeal.

8 Mr. MacMillan contends that Messrs. Lee, Fung and Dick, acting on behalf of LFD and in their personal capacities, offered him an equity position in Concorde. According to Mr. MacMillan, the parties had discussed the prospect of him acquiring shares as early as 1990. Mr. MacMillan specifically alleges that later, in either November or December 1995, he and Mr. Lee "shook hands" in order to confirm an agreement whereby he would receive 10% of the shares in Concorde. Mr. MacMillan says that it was the promise of an equity interest that induced him to continue providing his services and to cooperate in the assignment of patents. He says that a memorandum Mr. Lee wrote to Mr. Fung in October 1995 confirms the knowledge of LFD's stakeholders in this regard. Part of that memorandum reads as follows:

> [Mr. MacMillan] is not on board. There is a real crisis here. We have increased our cash to him to $35,000 in order to renew the agreement with him for assignment of patents . . . [H]e has refused our offer. He knows well that our past agreement is no longer valid as we are in total default of our commitments.
>
> . . .
>
> The most important and the most urgent help that I need from you is in connection with the patents . . . . Unless I hear from you very soon, I shall use my judgement to pay for any price and use any other reasonable means to secure the assignment of the patents.

9 The respondents' position throughout this litigation has been that there was no firm agreement for Mr. MacMillan to receive any shares in Concorde and that the most that can be said is that an agreement was contingent upon a number of matters being addressed and "sorted out".

10 On this point, the trial judge found as follows, at para. 28 of her reasons:

> Memoranda between the principals of Concorde demonstrate that they knew MacMillan hoped to acquire equity in the company. From time to time, they discussed different mechanisms for MacMillan earning or being given an equity interest but no clear consensus emerged on the terms under which such equity would be acquired.

11 In any event, when the 1990 Consulting Agreement terminated in June 1994, Mr. MacMillan continued his employment with Concorde. Between May 1994 and February 1995, Mr. MacMillan applied for four patents for tools that he had invented or improved. At trial, he maintained that those patents were "outside the scope of his employment". His position was contentious, to say the least. The trial judge concluded that the 1990 Consulting Agreement precluded him from claiming entitlement for tools that he invented while employed as a consultant by Concorde.

12 In 1994, Mr. Dick reduced his shareholding in LFD to 5%. The remaining shares were held by Kaiser, ACDEG and Mr. Lee's brother-in-law, the respondent Alfred Po-Hong Ma.

13 In November 1995, Mr. MacMillan and Kaiser entered into an employment agreement (the "1995 Employment Agreement"), pursuant to which Mr. MacMillan agreed to serve as Concorde's vice-president of operations. Kaiser paid Mr. MacMillan $35,000 as consideration for his agreement that all past, present and future patents and patentable concepts, including those registered in his name, were and would be the exclusive property of Kaiser.

14 It should be noted that Mr. MacMillan received independent legal advice by counsel who certified that he voluntarily agreed to be bound by the entire contents of the 1995 Employment Agreement after having received legal advice with respect to those contents. It is also crucial to note that the 1995 Employment Agreement contained an entire agreement clause. That clause read as follows:

> This contract constitutes the entire agreement between the parties with respect to the employment and appointment of [Mr. MacMillan] and any and all previous agreements, written or oral, express or implied, between the parties or on their behalf relating to the employment and appointment of [Mr. MacMillan] by the Employer, are terminated and cancelled and each of the parties releases and forever discharges the other of and from all manner of actions, causes of action, claims and demands whatsoever, under or in respect of any agreement.

15 On 1 October 1996, Messrs. Lee and MacMillan signed a so-called draft agreement in principle (the "1996 Draft Agreement in Principle"). Clause 12 of the document provided that it was "meant to be additional or supplementary to" the 1995 Employment Agreement and subject to the latter's conditions. The document described its purpose in these terms:

> We both agree that the fundamental spirit of this agreement is to encourage and to ensure that Mark MacMillan will work closely and harmoniously together so that someday Mark MacMillan can proudly say and we gladly and indisputably agree that he is not given the very lucrative rewards by us, he is in fact through his own personal involvement and his own personal contribution earning his own lucrative rewards with the Company as the platform and that his personal involvement and contribution is making our dream possible.

16 Clause 9 of the 1996 Draft Agreement in Principle reads as follows:

> With a clear understanding that the recovery of [Concorde] shares from Mr. David Dick and Mr. David Fung will provide a real and substantial mutual benefits to both, Mark MacMillan agrees to do everything in his power, including the immediate submission of an affidavit and testimony to support recovery of these shares. In light of this support and to fulfill prior loose understandings, the following will take place:

> *Through, and with your help and co-operation, 50% of any [Concorde] shares we can recover from David Fung and David Dick will be allocated to you. Our objective is to recover the full outstanding 25% of [Concorde] shares. This will provide Mark with 12.5% of [Concorde] shares with a view to promote the recovery of shares. We will support Mark MacMillan in the two legal disputes between David Fung and Mark MacMillan . . . .*

[Underlining emphasis added; italics in original.]

17 It is apparent that the document was prepared without legal advice or assistance, particularly as Messrs. Lee and Fung held shares in LFD, not Concorde.

18 On 27 February 1997, Kaiser terminated Mr. MacMillan's employment, alleging cause. However, the letter of termination did not specify any particular cause. Mr. MacMillan's dismissal shortly followed Kaiser registering with the U.S. Patent Office assignments of patents by Mr. MacMillan and Concorde to it.

19 In May 1997, Mr. MacMillan commenced five actions against Mr. Lee, Kaiser and Concorde in Provincial Court, Small Claims division. In December 1997, he and Mr. Dick established a new company, Northstar Tool Corporation, which is in the business of developing and marketing drywall tools. In 1999, the respondent Axia Incorporated ("Axia") (of which the respondent Ames Taping Tools Systems Company is an unincorporated division) purchased patents held by Kaiser and Concorde.

20 In April 2000, Mr. MacMillan commenced this action, and on 30 April 2003, the court below made an order dismissing it. Mr. MacMillan seeks a new order remitting the matter for trial.

ANALYSIS

Whether the trial judge erred in proceeding under Rule 18A

21 Counsel for Mr. MacMillan argues that the trial judge erred in interpreting the 1995 Employment Agreement on a summary trial basis since a fair determination of the issue required her to determine the validity of promises of shares alleged to be collateral to the agreement, respecting which there were serious credibility issues. He argues that the judge could not fairly have interpreted the agreement in light of the fact that it was necessary to consider extrinsic evidence marred by questions of credibility.

22 The principles relating to the applicability of the summary trial procedure are not in dispute. It should be noted that the mere fact that there is a conflict in the evidence does not in and of itself preclude a chambers judge from proceeding under Rule 18A. A summary trial almost invariably involves the resolution of credibility issues for it is only in the rarest of cases that there will be a complete agreement on the evidence. The crucial question is whether the court is able to achieve a just and fair result by proceeding summarily.

23 The leading case on the applicability of Rule 18A is *Inspiration Management Ltd. v. McDermid St. Lawrence Ltd.* (1989), 36 B.C.L.R. (2d) 202 (B.C. C.A.). In that case, the chambers judge had dismissed the plaintiff's application for judgment under Rule 18A because she said that judgment ought not to be given under the rule "unless it is clear that a trial in the usual way could not possibly make any difference in the outcome". In allowing the appeal, McEachern C.J.B.C. set out the policy reasons for the rule at 211:

> [Rule 18A] was added to the Rules of Court in 1983 in an attempt to expedite the early resolution of many cases by authorizing a judge in chambers to give judgment in any case where he can decide disputed questions of fact on affidavits or by any of the other proceedings authorized . . . unless it would be unjust to decide the issues in such a way.

24 He continued at 212 by quoting with approval this passage from *Placer Development Ltd. v. Skyline Explorations Ltd.* (1985), 67 B.C.L.R. 366 (B.C. C.A.), at 386 [*Placer Development*]:

> The rule must, however, be applied only where it is possible to do justice between the parties in accordance with the requirements of the rule itself and in accordance with the general principles which govern judges in their daily task of ensuring that justice is done.

25 He then said this, at 214:

> In deciding whether it will be unjust to give judgment the chambers judge is entitled to consider, inter alia, the amount involved, the complexity of the matter, its urgency, any prejudice likely to arise by reason of delay, the cost of taking the case forward to a conventional trial in relation to the amount involved, the course of the proceedings and any other matters which arise for consideration on this important question.

26 Finally, in relation to evidentiary problems, he said this at 215-16:

> Lastly, I do not agree . . . that a chambers judge is obliged to remit a case to the trial list just because there are conflicting affidavits. In this connection I prefer the view expressed in [***Placer Development**, supra*]. Subject to what I am about to say, a judge should not decide an issue of fact or law solely on the basis of conflicting affidavits even if he prefers one version to the other. It may be, however, notwithstanding sworn affidavit evidence to the contrary, that other admissible evidence will make it possible to find the facts necessary for judgment to be given . . . .

27 In *Orangeville Raceway Ltd. v. Wood Gundy Inc.* (1995), 6 B.C.L.R. (3d) 391 (B.C. C.A.), this Court affirmed the decision of a chambers judge who granted summary judgment where credibility was the decisive issue through reliance on undisputed documentary evidence.

28 There is no doubt that this case was complex from an evidentiary perspective. Mr. MacMillan's contention that the respondents promised him an equity position in Concorde was based on oral promises alleged to have been made by several of the respondents at various points in time.

29 The judge concluded, in spite of the evidentiary conflicts, that she was able to deal with the matter on a summary basis. At the outset of her reasons, at para. 2, she stated:

> . . . I propose to examine the "final" proposed amended statement of claim against the background of the documentary evidence. If the plaintiff's pleadings cannot withstand that scrutiny, then it is unnecessary to analyze the defendants' extensive attacks on the plaintiff's credibility.

30 She concluded on this point with the following words, at paras. 72-73:

> . . . While there are serious credibility issues in this case that, in my view, are not amenable to summary resolution, the defendants argue that the necessary facts can be determined on the basis of the extensive documentary evidence.
>
> I have concluded that the matter is suitable for disposition by summary judgment.

31 It is clear that the judge was alive to the conflicts in the evidence. She was able to resolve the conflicts by making reference to and relying on the extensive documentary evidence before her. I agree with her decision in that regard.

32 The decision to proceed in a summary manner was sound for two other reasons. First, a conventional trial in this case would necessarily have involved lengthy proceedings coming at prohibitive cost. From that perspective, it made good sense to proceed under Rule 18A. Second, the judge had examined the law and concluded (as do I, below) that the facts alleged by Mr. MacMillan, even taken at face value, gave rise to no claim in law. A conflict in the evidence cannot require a trial where the evidence in question is irrelevant to the legal issues at hand.

33 This is a case in which the chambers judge obviously weighed the arguments carefully and determined that she could fairly try the case under Rule 18A. I do not think that she exercised her discretion improperly. For these reasons, Mr. MacMillan's argument on this issue must fail.

Whether the trial judge erred in concluding that the entire agreement clause in the 1995 Employment Agreement was not rebutted or modified by a collateral promise of shares

34 In the court below, Mr. MacMillan alleged that he was induced to enter into the 1990 Share Purchase Agreement, 1990 Consulting Agreement and 1995 Employment Agreement by promises made by Messrs. Lee, Fung and Dick (acting both on behalf of LFD and personally) that he would receive a 10% stake in Concorde. Mr. MacMillan contended that he would not have signed any of the agreements if the respondents had not promised him shares. Though the alleged promises were not in writing, Mr. MacMillan said that it was the intention of all parties that he receive some type of ownership interest.

35 On this appeal, the narrow issue raised in this respect is whether the entire agreement clause in the 1995 Employment Agreement could be rebutted or modified by extrinsic evidence of a collateral promise of shares. The trial judge said that it could not. Counsel for Mr. MacMillan argues that she erred in that respect.

36 The starting point in any discussion on this issue is the general rule that a written contract in clear terms cannot be varied or qualified by extrinsic evidence: see *Hawrish v. Bank of Montreal*, [1969] S.C.R. 515 (S.C.C.) [*Hawrish*]. In that case, the guarantor of a line of credit was sued by the bank on his guarantee. The guarantor alleged in his defence that the manager of the bank had orally assured him that he would be released from his guarantee under certain conditions. The Supreme Court of Canada held that the oral assurance could provide no defence, because it would have contradicted the terms of the written guarantee bond. Judson J., writing for the unanimous court, reviewed the authorities supporting that result at 518-21:

> In the last half of the 19th century a group of English decisions, of which *Lindley v. Lacey* [(1864), 17 C.B.N.R. 578, 144 E.R. 232.], *Morgan v. Griffith* [(1871), L.R. 6 Exch. 70.] and *Erskine v. Adeane* [(1873), 8 Ch. App. 756.] are established that where there was parol evidence of a distinct collateral agreement which did not contradict nor was inconsistent with the written instrument, it was admissible. These were cases between landlord and tenant in which parol evidence of stipulations as to repairs and other incidental matters and as to keeping down game and dealing with game was held to be admissible although the written leases were silent on these points. These were held to be independent agreements which were not required to be in writing and which were not in any way inconsistent with or contradictory of the written agreement.
>
> . . .
>
> The appellant has relied upon *Byers v. McMillan* [(1887), 15 S.C.R. 194]. But upon my interpretation that the terms of the two contracts conflict, this case is really against him as it is there stated by Strong J. that a collateral agreement cannot be established where it is inconsistent with or contradicts the written agreement. To the same effect is the unanimous judgment of the High Court of Australia in *Hoyt's Proprietary Ltd. v. Spencer* [(1919), 27 C.L.R. 133.], which rejected the argument that a collateral contract which contradicted the written agreement could stand with it.

37 In this case Mr. MacMillan's counsel relies on *Turner v. Visscher Holdings Inc.* (1996), 23 B.C.L.R. (3d) 303 (B.C. C.A.) [*Turner*], and *Zippy Print Enterprises Ltd. v. Pawliuk* (1994), 100 B.C.L.R. (2d) 55 (B.C. C.A.) [*Zippy Print*]. In *Turner*, *supra*, the parties had entered into a written contract pursuant to which the defendant would purchase the plaintiff's interest in a company. The contract contained an entire agreement clause. The plaintiff alleged that the parties had also entered into two oral contracts, so-called employment and bonus agreements, and sought to enforce the latter of them. In dismissing the defendant's appeal, the majority of this Court stated that the entire agreement clause in the written contract did not apply to preclude operation of the collateral bonus agreement, since the parties had conducted themselves in accordance with the collateral employment agreement and thus evidenced a clear intention not to have the

written contract encompass all their contractual relations, its entire agreement clause notwithstanding. Finch J.A. (as he then was) expressed the point in these terms:

> [7] The fact that both parties entered and acted upon an oral contract of employment is a clear indication that clause 22, the "entire agreement clause", was not intended to govern all contractual relations between "the parties".

38 Newbury J.A. delivered dissenting reasons in *Turner*, *supra*. They are relevant to this case insofar as they discuss the policy reasons for the general rule against giving effect to collateral agreements that contradict a written entire agreement clause. In commenting upon *Hawrish*, *supra*, Newbury J.A. stated:

> [23] . . . the passage is a reminder that there are good policy reasons for regarding claims based on collateral contract with suspicion, where the "sole effect [thereof] . . . is to vary or add to the terms of the principal contract".
>
> . . .
>
> [35] But where as here the parties are both commercial entities or where they have in fact negotiated the terms of their agreement with the benefit of legal advice, courts have enforced "entire agreement" and similar provisions on many occasions. In addition to *Carman Construction, supra*, I note the decision of the majority of the Ontario Court of Appeal in *Hayward v. Mellick*, [45 O.R. (2d) 110]. It involved a negligent misrepresentation made orally concerning the acreage of a farm, and a clause in a written agreement for the sale of the farm which stated that there were no "representations, warranties or conditions, expressed or implied, other than those herein contained . . . ". In response to the argument that the clause did not exclude negligent representations, the majority said it would be "too strained a construction of the disclaimer clause to say that it applies only to representations that are not negligent". Thus the buyer of the farm was precluded from relying on the misrepresentation and was bound by the written contract.
>
> [36] The Supreme Court of British Columbia has also given effect to "entire agreement" clauses in the context of negotiated agreements . . . . In so doing, courts have almost invariably equated such clauses with the parol evidence rule . . . .
>
> [37] Given the rule of construction that a court should strive to give effect to all the terms of an agreement, however, it is at least arguable that a provision such as [the entire agreement clause] must be intended to have a broader effect than the parol evidence rule would have by itself - otherwise, the clause would be redundant. Certainly the wording used here was not limited to "any agreement, representation or warranty that contradicts or varies" the terms of the written agreement - the clause stated that there were no collateral agreements between the parties, whether at variance with the written document or not. In practical terms, the obvious purpose of such a clause is to ensure that parties who have conducted oral negotiations, from which (as this case illustrates) misunderstandings might easily arise, will finally review and by execution confirm in writing the terms they have agreed upon. It is a normal and in my view legitimate expectation in the commercial world that, absent fraud or some other vitiating element, provisions such as [the entire agreement clause] will generally be given effect to, so that prior discussions concerning the contract may not prevail over what has been acknowledged in writing to constitute the parties' "entire agreement."
>
> [38] In any event, whether one applies the wording of [the entire agreement clause] itself - an acknowledgment that no collateral agreements exist - or whether one applies the parol evidence rule to it and therefore disallows proof of the collateral contract because such a result would contradict [the entire agreement clause], the conclusion seems inescapable that the collateral oral contract cannot prevail. To rule otherwise would in my view render entire agreement clauses meaningless and thereby remove an important safeguard used in countless agreements in this province and elsewhere.

[Emphasis added.]

39 In *Zippy Print, supra*, the defendants alleged that the plaintiff had made oral representations that induced them to enter into a franchise licence agreement. The trial judge found the plaintiff's representations to have been false and thus dismissed its claim under the agreement. The plaintiff appealed, contending that the trial judge had ignored an entire agreement clause in the licence agreement that would have precluded consideration of the representations. In dismissing the plaintiff's appeal, Lambert J.A. made the following comments at para. 36:

> The representations in this case were made on behalf of [the plaintiff] in order to induce [the defendants] to enter into the license agreement. To exclude evidence of the representations on the basis of the Parol Evidence Rule, which is no longer, in the context of trials conducted by judges without juries, a rule of evidence at all, would be absurd. The real question raised by the Parol Evidence Rule is whether the license agreement in its printed form was intended to constitute the entire agreement and to supersede and replace the representations that were designed to bring it about and to nullify any prior agreement or any prior terms that were discussed but never incorporated in the written agreement.

40 Counsel for Mr. MacMillan relies on *Zippy Print, supra*, to argue that the entire agreement clause does no more than strengthen the presumption that the 1995 Employment Agreement is the whole agreement between the parties - a presumption that he says may be rebutted by extrinsic evidence as to the parties' true intention.

41 The trial judge in this case made no findings of fact relating to the promises alleged by Mr. MacMillan, having concluded that the entire agreement clause in the 1995 Employment Agreement ruled out any argument by Mr. MacMillan with respect to a collateral promise of shares. In that regard, she relied on *Gutierrez v. Tropic International Ltd.* (2002), 162 O.A.C. 247 (Ont. C.A.) [*Gutierrez*], a case in which the Ontario Court of Appeal held that an action on a written agreement containing an entire agreement clause could not be defended on the basis of an alleged oral collateral agreement. *Gutierrez* in turn cites the decision of McLachlin C.J.S.C. (as she then was) in *Power Consolidated (China) Pulp Inc. v. British Columbia Resources Investment Corp.*, [1988] B.C.J. No. 1403 (B.C. C.A.) [*Power Consolidated*].

42 In *Power Consolidated, supra*, the plaintiffs, who had entered into an agreement to purchase a pulp mill, brought an action on the basis of an alleged oral contract collateral to the main contract, which included an entire agreement clause. The defendants applied for judgment under Rule 18A, contending that the plaintiff had no cause of action. McLachlin C.J.S.C. dealt with the application as follows:

> The alleged warranty is not contained in the contract documents. Therefore, if it exists, it must be a collateral contract.
>
> The doctrine of collateral contract is simple. Where one party makes a promise, in exchange for which the other party enters into a contract, the promise may be considered as a separate contract "collateral" to the main contract.
>
> . . . . .
>
> . . . the question is whether the intention of the parties in the case at bar was that the written contract together with the specified appendices would constitute the whole of the contract. That intention, as in all matters relating to contractual construction, must be determined objectively. Here the parties expressly agreed that the contract documents constituted the whole of their agreement. While in most cases such an agreement is only a presumption based on the parol evidence rule, in this case it has been made an express term of the contract. A presumption can be rebutted; an express term of the contract, barring mistake or fraud, cannot. I have no alternative but to conclude that the parties intended the contract documents to be the whole of their agreement and the plaintiffs cannot rely on collateral contract against Westar.
>
> [Emphasis added.]

43 In this case, counsel for Mr. MacMillan argues that the intention of all parties was that Mr. MacMillan receive an equity position in Concorde. He says that evidence relating to the respondents' collateral promises must be considered in order to determine whether the entire agreement clause in the 1995 Employment Agreement was truly intended to exclude those promises.

44 In my view, this argument overlooks the fact that the courts have adopted an objective standard in determining the intention of contracting parties. In *The Law of Contract in Canada*, 4th ed. (Scarborough: Carswell, 1999) by Professor G.H.L. Fridman, the learned author has fairly set out the law at 17:

> . . . The law is concerned not with the parties' intentions but with their manifested intentions. It is not what an individual party believed or understood was the meaning of what the other party said or did that is the criterion of agreement; it is whether a reasonable man in the situation of that party would have believed and understood that the other party was consenting to the identical terms. The common law embraced this attitude of objectivity in the determination of contractual relations . . . .

45 In this case it is apparent that Mr. MacMillan failed to establish that the alleged collateral agreement for or promises of shares survived the entire agreement clause in the written agreement. It is important to note that the 1995 Employment Agreement was negotiated between knowledgeable, sophisticated businesspersons. Mr. MacMillan was represented by independent counsel who presumably gave him legal advice relating to his rights and obligations. Clearly, from a policy perspective, an agreement that is negotiated between sophisticated businesspersons ought to be enforced in accordance with the terms they select in all but the most exceptional circumstances. There is no suggestion that the parties to the agreement in this case were unequal in any sense. Moreover, there is no evidence of mistake or fraud.

46 In my view both *Turner*, *supra*, and *Zippy Print, supra*, are distinguishable on their facts. In *Turner*, the parties acted on a collateral agreement, and by doing so, gave every indication that the written agreement containing the entire agreement clause did not actually constitute the entire agreement. Similarly, in *Zippy Print*, it was clear that the oral representations were made in order to induce the defendants to enter into the written contract and that the defendants relied on those representations.

47 At trial, counsel for Mr. MacMillan also argued that the entire agreement clause in the 1995 Employment Agreement was at best limited to the "employment and appointment" of Mr. MacMillan and thus would not extend to matters such as the assignment of patents or a promise of shares. The trial judge dealt with that argument as follows at paras. 108-09:

> In my opinion, the "employment" of MacMillan included all of the terms of the 1995 Employment Agreement that defined his employment. Those terms required the plaintiff to assign both the Early and New Patents to [Kaiser], prevented him from acquiring patentable rights to work done "outside his employment", and set out the terms of his remuneration. It is significant that MacMillan, after receiving the benefit of legal advice, signed the 1995 Employment Agreement which provided for a monthly salary of $5,540 as consideration for his continued employment and $35,000 as consideration for vesting all of the patents in [Kaiser].
>
> Accordingly, I conclude that the express terms of the 1995 Employment Agreement constitute the entire agreement between the parties as to all of the terms of MacMillan's employment. Clause 23 precludes him from claiming that he was induced to continue his employment and assign the patents by the representations of Lee and Young that he would receive 10% of the shares of Concorde.

48 I can see no error in the judge's reasoning in this regard. Any promise of shares to Mr. MacMillan would have represented compensation for his employment with Concorde. Surely a contract relating to such compensation would be a contract relating to "employment" and thus within the scope of the entire agreement clause.

49 For these reasons Mr. MacMillan's argument on this issue must fail.

Whether the trial judge erred in finding that the 1996 Draft Agreement in Principle was not enforceable

50 Counsel for Mr. MacMillan argues, finally, that the trial judge erred in concluding that the 1996 Draft Agreement in Principle was not enforceable. He says the document finally put the respondents' promise of Concorde shares in writing, and raises a genuine issue for trial, namely the extent of Mr. MacMillan's right to shares under its terms.

51 In discussing the 1996 Draft Agreement in Principle, the trial judge correctly expressed concern as to what value Concorde's shares would have had at the time the 1996 Draft Agreement in Principle was produced, since Kaiser held all relevant patents. She also noted the erroneous reference in the document to the recovery of Concorde shares from Messrs. Dick and Fung, before concluding in this way, at para. 50:

> . . . In my view, the reference in Clause 9 to "prior loose understandings" is significant. It negates any suggestion that there had [ever] been a firm agreement in place between the parties.

52 There is no doubt that in assessing Mr. MacMillan's claim the judge found as a fact that there was no firm agreement between the parties relating to the transfer of shares to Mr. MacMillan. In assessing the uncertain nature of Mr. MacMillan's claim, she stated as follows at paras. 28-29:

> Memoranda between the principals of Concorde demonstrate that they knew MacMillan hoped to acquire equity in the company. From time to time, they discussed different mechanisms for MacMillan earning or being given an equity interest but no clear consensus emerged on the terms under which such equity would be acquired . . . .
>
> However, nothing was finalized between the shareholders and no written proposals or agreements were conveyed to MacMillan.

53 I cannot conclude that the trial judge erred in law in coming to her conclusion, or that she made a palpable and overriding error with respect to evidentiary matters. In *Housen v. Nikolaisen*, [2002] 2 S.C.R. 235 (S.C.C.), the court held that the standard of review for inferences of fact is not verification that the inference can reasonably be supported by the findings of fact of the trial judge, but whether the trial judge made a palpable and overriding error in coming to a factual conclusion based on accepted facts, a stricter standard.

54 The trial judge made no such error in this case.

CONCLUSION

55 In summary, I do not believe that the trial judge, Allan J., erred in concluding that she could try this case on a summary basis by relying on the plaintiff's pleadings and accepting at face value the allegations contained in them. The decision to proceed under Rule 18A did not result in any prejudice or injustice to Mr. MacMillan since she accepted as factual his allegations contained in his pleadings. Moreover, I cannot conclude that the trial judge erred in refusing to consider the collateral promises alleged by Mr. MacMillan in light of the entire agreement clause in the 1995 Employment Agreement. Finally, I agree with the finding of the trial judge that the 1996 Draft Agreement in Principle is not an enforceable agreement.

56 For these reasons I would dismiss the appeal.

Donald J.A.:

I Agree:

Sauders J.A.:

I Agree:

Appeal dismissed.

End of Document

TAB 13

1989 CarswellBC 37
Supreme Court of Canada

Syncrude Canada Ltd. v. Hunter Engineering Co.

1989 CarswellBC 37, 1989 CarswellBC 703, [1989] 1 S.C.R. 426, [1989] 3 W.W.R. 385, [1989] B.C.W.L.D. 1283, [1989] C.L.D. 691, [1989] S.C.J. No. 23, 14 A.C.W.S. (3d) 277, 35 B.C.L.R. (2d) 145, 57 D.L.R. (4th) 321, 92 N.R. 1, J.E. 89-571, EYB 1989-66979

HUNTER ENGINEERING COMPANY INC. (HUNTER MACHINERY CANADA LTD.), INTEGRATED METAL SYSTEMS CANADA LTD. and ALLIS-CHALMERS CANADA LTD. v. SYNCRUDE CANADA LTD. et al.

Dickson C.J.C., Estey *, McIntyre, Wilson, Le Dain **, La Forest and L'Heureux-Dubé JJ.

Heard: February 25 and 26, 1988
Judgment: March 23, 1989
Docket: No. 19773, 19950

Counsel: *J. Giles, Q.C.*, and *R. McDonell*, for appellants Hunter Engineering Inc. et al.
D.M.M. Goldie, Q.C., and *P.G. Plant*, for appellant Allis-Chalmers Canada Ltd.
D.B. Kirkham, Q.C., and *G.S. McAlister*, for respondents Syncrude Canada Ltd. et al.

Subject: Contracts; Restitution; Property

Headnote

Contracts --- Performance or breach — Breach — Fundamental breach — General

Restitution --- Bars to recovery — No benefit conferred

Sale of Goods --- Statutory contract — Condition — Express condition — Effect

Contracts — Discharge — Breach — Fundamental breach — Exclusion clauses — Plaintiff entering into contract with second defendant for supply of conveyor systems including mining gearboxes — Contract excluding statutory warranties and defects appearing after expiry of term of contractual warranty — Gearboxes defective but repairable — Breach not amounting to fundamental breach — In any event, exclusion clause excluding fundamental breach.

Sale of goods — Contract of sale — Implied conditions and warranties — Quality and fitness — Plaintiff entering into contract with defendants for supply of conveyor systems including mining gearboxes — Gearboxes defective due to design errors within contractual responsibility of defendants — Although defects appearing after expiry of term of contractual warranty, contract with first defendant not excluding warranty of fitness under Sale of Goods Act — Contract with second defendant excluding statutory warranties and fundamental breach not applying.

Trusts — Constructive trusts — Third party fraudulently misrepresenting to plaintiff that it was Canadian subsidiary of defendant — Plaintiff contracting with third party for purchase of certain machinery — Defendant commencing passing off action — Plaintiff establishing trust with moneys intended to pay for machinery — Defendant successful in passing off action but unwilling to assume warranties as required by trust — Defendant not being entitled to moneys under unjust enrichment or under terms of trust.

Contracts — Discharge — Breach — Defective performance — Plaintiff entering into contract with first defendant for supply of mining gearboxes — Gearboxes defective due to design errors within contractual responsibility of defendant — Although defects appearing after expiry of term of contractual warranty, contract not excluding warranty of fitness under Sale of Goods Act — Defendant liable for breach of statutory warranty of fitness.

Sale of goods — Contract of sale — Discharge — Breach — Fundamental breach — Exclusion clauses — Plaintiff entering into contract with second defendant for supply of conveyor systems including mining gearboxes — Contract excluding statutory warranties and defects appearing after expiry of term of contractual warranty — Gearboxes defective but repairable — Breach not being fundamental breach — In any event, exclusion clause excluding fundamental breach.

The plaintiff S. operated a synthetic oil plant. It entered into three contracts to obtain mining gearboxes for use at the plant. The first contract was with the defendant H.(U.S.) for the supply of 32 gearboxes at a total price of $464,000. Under the contract H.(U.S.) was to "furnish all labour and material for the design, fabrication and delivery ..." of the gearboxes, and while S. supplied specifications as to what the gearboxes were required to do, H.(U.S.) bore sole responsibility for their correct and adequate design. The gearboxes were manufactured by a subcontractor. The second contract, with the defendant A.-C., was for the supply of 14 conveyor systems, at a price in excess of $4,000,000, four of which included gearboxes. These gearboxes were also made by the same subcontractor and according to the same design.

Both contracts contained provisions that the contract and the rights of the parties were to be governed by the laws of Ontario, and both contained warranties which expired on the earlier of 24 months after delivery or 12 months after the gearboxes entered service. However, the contract with A.-C. also included a clause that those provisions represented the only warranty, and that "no other warranty or conditions, statutory or otherwise shall be implied".

The third contract was with H.(Can.) for an additional 11 gearboxes. S. had been approached by employees of H.(U.S.), who said they now represented a Canadian subsidiary of H.(U.S.). However, these representations were fraudulent, and H.(Can.) was in fact an independent company with no connection with H.(U.S.). The warranty provision of this contract was unlimited in time. These gearboxes were of the same design as the original gearboxes and H.(Can.) also contracted with the same subcontractor as H.(U.S.). After work had commenced but before S. made any payments to H.(Can.), H.(U.S.) discovered the deception, alerted S. and commenced a passing off action against H.(Can.) and its owners. S., which had an urgent need for the gearboxes, secured a waiver from H.(Can.) of any interest arising under contract subject to the creation of an acceptable trust agreement.

S. then entered into an agreement directly with the subcontractor under which the latter would manufacture the gearboxes for S. at the price it would have received from H.(Can.), and established a trust fund into which were paid the moneys that would have been payable to H.(Can.). The subcontractor was to be paid its contract price out of the fund, with an amount representing the profit H.(Can.) would have made to be payable to the successful party in the litigation between H.(Can.) and H.(U.S.), provided that that party agreed to assume the warranty and service obligations of H.(Can.). The trust further provided that if the holder of the interest in the trust fund and S. were unable to agree with respect to the warranty and service of work, the balance of the trust moneys were to be paid to S. Both H.(U.S.) and H.(Can.) had knowledge of the agreements with the subcontractor and the trust agreement but they were not parties to either agreement. H.(U.S.) succeeded in its action against H.(Can.), but it refused to assume the warranty provisions of H.(Can.)'s contract.

Between one and two years after they were put in service, problems were discovered in the gearboxes. Although the gearboxes should have lasted ten years, the thickness of steel plates and the way in which the housing was welded together was inadequate and they were too weak for service. Both H.(Can.) and A.-C. refused warranty coverage,

and S. repaired the gearboxes at a cost of some $700,000 with respect to those obtained from H.(U.S.), $400,000 with respect to those obtained from A.-C., and $200,000 with respect to those which had been the subject of the contract with H.(Can.). S. commenced an action against H.(U.S.) and A.-C., and by third party notice A.-C. claimed contribution or indemnity from H.(U.S.). H.(U.S.) claimed entitlement to the moneys in the trust.

The trial judge held that the failure of the gearboxes was due to design fault and that this was H.(U.S.)'s responsibility. He held that the time limit in the contractual warranties excused H.(U.S.) and A.-C. from liability under those provisions, but that the warranty of fitness in s. 15(1) of the Ontario Sale of Goods Act applied to the contract between S. and H.(U.S.) and that H.(U.S.) had breached that warranty. Accordingly, the trial judge awarded judgment against H.(U.S.). However, the trial judge held that the statutory warranty was excluded in the contract between S. and A.-C., and he rejected S.'s claim that A.-C. had committed a fundamental breach so as to negate the exclusion clause. Accordingly, the trial judge dismissed the action against A.-C. and its third party notice. Finally, the trial judge held that H.(U.S.) was entitled to the principal in the trust fund, but only if it met the conditions of the H.(Can.) contract, and he allowed time for H.(U.S.) to assume the warranty and service obligations. The Court of Appeal dismissed H.(U.S.)'s appeal on the question of liability, allowed the plaintiffs' appeal against the dismissal of the action as against A.-C., and allowed H.(U.S.)'s appeal on the ownership of the trust fund. H.(U.S.) and A.-C. appealed the finding of liability and the plaintiffs cross-appealed with respect to the ownership of the trust fund.

Held:

H.(U.S.)'s appeal dismissed; A.-C.'s appeal allowed; plaintiffs' cross-appeal allowed.

I Liability of H.(U.S.)

Per WILSON J. (L'HEUREUX-DUBÉ and MCINTYRE JJ. concurring): It was apparent that under its contract H.(U.S.) was responsible for deciding specific design details, and that S.'s specifications were only specifications as to what the gearboxes were required to do, not of how they were actually to be built. Accordingly, H.(U.S.) was responsible for the design flaw that caused the gearboxes to fail.

Although the contract warranty period had expired, the statutory warranty of fitness in s. 15(1) of the Ontario Sale of Goods Act applied. Considering that an exclusion clause should be strictly construed against the party seeking to invoke it, and that clear and unambiguous language is required to oust an implied statutory warranty, the statutory warranty was not excluded by the contract. Moreover, it was abundantly clear that S. informed H.(U.S.) of the purpose for which the gearboxes were required and relied on its expertise, that the gearboxes were goods which were in the course of H.(U.S.)'s business to supply, and that they were not reasonably fit for their purpose. Accordingly, H.(U.S.) was liable for the cost of repairing the gearboxes it supplied.

Per DICKSON C.J.C. (LA FOREST J. concurring): Upon its true construction the contract between S. and H. (U.S.) placed the responsibility for the design of the gearboxes solely on H.(U.S.). The words of the contract clearly indicated a creative role for H.(U.S.), and the specifications S. supplied were specifications as to what the gearboxes were required to do, not how they were to be built. Moreover, H.(U.S.) failed to discharge its responsibility with respect to the adequacy of their design.

The contractual warranty had expired, and S. was not entitled to rely on that warranty. However, the statutory warranty in s. 15(1) of the Ontario Sale of Goods Act applied. While s. 53 provides for contracting out of the provisions of the Act, this must be done by clear and direct language and the mere presence of an express warranty does not mean that the express and statutory warranties are inconsistent so as to exclude the statutory warranties. Finally, the three prerequisites for the application of s. 15(1) were satisfied and H.(U.S.) was liable under that section.

II Liability of A.-C.

Per WILSON J. (L'HEUREUX-DUBÉ J. concurring): The provision in the A.-C. agreement explicitly and unambiguously ousted the statutory warranty and it was effective to prevent the application of s. 15(1) of the Sale of Goods Act.

A fundamental breach occurs where the event resulting from the failure by one party to perform a primary obligation has the effect of depriving the other party of substantially the whole benefit which it was the intention of the parties he should obtain. Fundamental breach gives the innocent party the election to put an end to all the remaining contractual obligations, and this is an exceptional remedy which should be available only where the foundation of the contract has been undermined and the very thing bargained for has not been provided. Here the breach of the A.-C. contract with respect to the gearboxes was not a fundamental breach. Although the gearboxes were an important part of the conveyor systems, the cost of their repair was only a small part of the total cost and their inferior performance did not deprive S. of substantially the whole benefit of the contract. Moreover, as the gearboxes did work for a period of time and were repairable, the breach did not go to the very root of the contract and was not fundamental to it.

In any event, even if the breach were fundamental, it was excluded by the terms of the contractual warranty. While no rule of law invalidates or extinguishes exclusion clauses in the event of fundamental breach, and exclusion clauses should be given their natural and true construction so that the parties' agreement is given effect, the court must still determine whether in the context of the particular breach which has occurred it is fair and reasonable to enforce the clause in favour of the party who committed that breach. Although the courts are unsuited to assess the fairness or reasonableness of contractual provisions as the parties negotiated them, and a requirement that an exclusion clause should be fair and reasonable per se should be rejected, it is a different matter for the courts to determine after a particular breach has occurred whether an exclusion clause should be enforced. In the absence of specific legislation, the courts must continue to develop a balance through the common law between the desirability of allowing the parties to make their own bargains and having them enforced by the courts and the undesirability of having the courts used to enforce a bargain in favour of a party which is itself totally repudiating that bargain. Whether this is addressed narrowly in terms of fairness between the parties, or on a broader, and preferably, policy basis of the need to balance conflicting values inherent in the contract law, the question is essentially the same: in the circumstances that have happened, should the court lend its aid in enforcing the clause?

There are other means available to render exclusion clauses unenforceable even in the absence of a finding of fundamental breach, including statutory provisions dealing with consumer sales and unconscionability stemming from inequality of bargaining power. However, where, as here, there is no inequality of bargaining power, the courts should, as a general rule, give effect to the bargain. Nonetheless, there is some virtue in a residual power residing in the court to withhold its assistance on policy grounds in appropriate circumstances. To abandon the doctrine of fundamental breach and rely solely on unconscionability would require an extension of the principle of unconscionability beyond inequality of bargaining power, and arguably it would be even less certain than the doctrine of fundamental breach.

Here, even if the breach were fundamental, there would be nothing unfair or unreasonable, or unconscionable, in giving effect to the exclusion clause: the parties were of roughly equal bargaining power, familiar with this type of contract, and there was no evidence A.-C. was guilty of sharp or unfair dealing.

Per DICKSON C.J.C. (LA FOREST J. concurring): The warranty clauses in the A.-C. contract effectively excluded liability for defective gearboxes after the warranty period ended.

In the context of deciding whether to enforce exclusion clauses the doctrine of fundamental breach should be replaced with a rule that holds the parties to the terms of their agreement, provided the agreement is not unconscionable. Accordingly, if on its true construction the contract excludes liability for the kind of breach that occurred, the party in breach will be saved from liability unless the contract is unconscionable. While the motivation underlying the continuing use of fundamental breach as a rule of law to relieve parties from the effects of unfair bargains may be laudatory, the doctrine has spawned a host of difficulties, the most obvious of which is in determining whether a particular breach is fundamental. As well, not all exclusion clauses are unreasonable, and they are not the only contractual provisions which may lead to unfairness. Accordingly, there is no sound reason for applying special rules in the case of exclusion clauses than in the case of other clauses producing harsh results.

Here the warranty clause excluded liability for the defects that materialized and, as unconscionability was not an issue, the parties should be held to the terms of their bargain.

Per MCINTYRE J.: Any breach of the contract by A.-C. was not fundamental, and in any event its liability would be excluded by the terms of the contractual warranty even if the breach were fundamental. Accordingly, it was unnecessary to deal further with the concept of fundamental breach in this case.

III Entitlement to the trust fund

Per DICKSON C.J.C (LA FOREST and MCINTYRE JJ. concurring): There was no basis in law or in equity for awarding the trust moneys to H.(U.S.). As H.(U.S.) maintained that it was not bound by the terms of the trust agreement and not obliged to honour any warranty or service obligations as a condition of payment to it of the trust moneys, it was not entitled to those moneys under the trust agreement. Nor had it satisfied any of the criteria necessary to establish a claim for unjust enrichment. As between H.(U.S.) and H.(Can.), H.(U.S.) had the better claim to the money accruing to H.(Can.) under S.'s contract with H.(Can.), and would be entitled to claim any profits made by H.(Can.) under both the traditional doctrine of constructive trust and unjust enrichment. However, as between S. and H.(Can.), S. had a stronger claim to the money: the relationship between S. and H.(Can.) was regulated by a contract which S. entered into on the basis of H.(Can.)'s fraudulent misrepresentation and which was therefore voidable at the instance of S. As the only connection between H.(U.S.) and S. was H.(Can.), H.(U.S.) had no higher claim against S. than did H.(Can.). Accordingly, the result of S.'s decision to terminate H.(Can.)'s contract and H.(Can.)'s acceptance of that termination was that H.(Can.) was no longer entitled to any payment under the contract and this precluded any claim by H.(U.S.).

The creation of the trust by S. was not an admission that either H.(U.S.) or H.(Can.) was entitled to the profit under the H.(Can.) contract. Upon suspecting fraud, S. was entitled to rescind the contract. Accordingly, it did not need to obtain the acceptance of H.(Can.) and create the trust fund, and it should not be worse off than it would have been had it simply rescinded the contract. At most, the establishment of the trust fund indicated S. was willing to pay the contract price if it received its negotiated warranties; it was not an admission that the trust moneys belonged to either H.(U.S.) or H.(Can.). Finally, the trial judge erred in declaring H.(U.S.) entitled to the trust moneys by assuming the warranty obligations after judgment without incurring liability for warranty claims prior to its assumption of the warranties.

Per WILSON J. (dissenting) L'HEUREUX-DUBÉ J. concurring): H.(U.S.) was entitled to the balance of the trust moneys. As the trust terms were not agreed to by the parties but were unilaterally established by S., the trial judge erred in holding that the fund should only be disposed of in accordance with the terms of the trust agreement. When the trust was established S. was perfectly prepared to acknowledge that the profit margin was payable to one of H.(U.S.) or H.(Can.), and in the circumstances the entitlement to the trust fund should be decided on the equitable principles governing unjust enrichment. S. would be enriched if allowed to retain the fund, as it would

receive interest income on money it initially intended to pay to H.(Can.). Moreover, if S. were permitted to keep the entire fund, H.(U.S.) would be correspondingly deprived of the interest income it would have earned on the contract for the supply of the additional gearboxes. There need not be a contractual link for the causal connection between contribution and enrichment to be proved, and on the facts of this case there was a sufficient causal connection. Finally, there was no juristic reason for the enrichment. Accordingly, provided it accepted the warranty terms of the H.(Can.) contract and paid for the costs of repairing the gearboxes, the trust fund minus administration expenses belonged in equity to H.(U.S.).

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Trade Practices Act, S.N. 1978, c. 10

s. 6(d)

Trade Practices Inquiry Act, R.S.M. 1987, c. T110 (also C.C.S.M., c. T110)

s. 2

Unfair Contract Terms Act, 1977 (U.K.), c. 50

Unfair Trade Practices Act, R.S.A. 1980, c. U-3

s. 4(b), (d)

Authorities considered:

Atiyah, Sale of Goods, 6th ed. (1980), p. 157

Fridman, Law of Contract in Canada, 2nd ed. (1986), pp. 531, 558.

Fridman, Sale of Goods in Canada, 2nd ed. (1979), pp. 203-204, 282, 531.

Ogilvie, "The Reception of *Photo Production Ltd. v. Securicor Transport Ltd.* in Canada: *Nec Tamen Consumebatur*" (1982), 27 McGill L.J. 424, p. 441.

Waddams, note (1981), 15 Univ. of B.C. L. Rev. 189.

Waddams, The Law of Contracts, 2nd ed. (1984), pp. 308, 249, 352-53.

Waddams, "Unconscionability in Contracts" (1976), 39 Modern L. Rev. 369.

Waters, The Law of Trusts in Canada, 2nd ed. (1984), pp. 378-82.

Ziegel, Comment (1979), 57 Can. Bar Rev. 105,, p. 113.

Appeal by defendants from judgment of British Columbia Court of Appeal, 68 B.C.L.R. 367, dismissing first defendant's appeal from judgment, 27 B.L.R. 59, finding it liable for breach of contract and allowing plaintiff's appeal from judgment

dismissing action against second defendant; Cross-Appeal by plaintiff as to portion of judgment allowing first defendant's appeal with respect to ownership of trust fund.

***Dickson C.J.C. (La Forest J.* concurring):**

1 Three main issues are raised in this appeal: (i) was Hunter Engineering Company Inc. ("Hunter U.S.") responsible for design faults which resulted in cracks in the bull gears of gearboxes used to drive conveyor belts at the oil sands operation of Syncrude Canada Ltd. ("Syncrude"); if so, is Hunter U.S. liable to Syncrude for breach of the implied warranty of fitness contained in s. 15(1) of the Ontario Sale of Goods Act, R.S.O. 1970, c. 421; (ii) is the "doctrine" of fundamental breach a part of Canadian contract law and what is its effect, if any, on the liability of Allis-Chalmers Canada Limited ("Allis-Chalmers") to Syncrude; (iii) can the law of constructive trust be extended to reach, for the benefit of Hunter U.S., moneys held under a trust agreement, to which Hunter U.S. was not a party, entered into by Syncrude in the unusual circumstances which will be described?

I Facts

2 Syncrude operates a multi-billion dollar synthetic oil plant at Fort McMurray, Alberta, where oil extracted from tar sands is processed. Large bucket wheels scoop sand from its natural state and load it onto conveyor belts, which in turn carry the sand a substantial distance to an extraction plant. Motive force from 1250 horsepower motors is transmitted to the conveyor belts through a series of gearboxes. The trial judge, Gibbs J. [27 B.L.R. 59], described a "gearbox" as a unit which comprises a collection of gears, shafts and bearings contained within a steel box or casing. Power generated by a motor is transmitted through a drive shaft into the gearbox, then through a series of intermediate gears to a very large (the larger type being 6 1/2 feet in diameter and the smaller 5 1/2 feet in diameter) "bull gear" which revolves, turning a large shaft set in the centre of the bull gear and extending outside the gearbox casing, to which shaft is attached a pulley which moves the conveyor belt.

3 In January 1975 Canadian Bechtel Ltd. ("Bechtel"), as agent for Syncrude, contracted with Hunter U.S. for the supply of 32 mining gearboxes for use at Syncrude's oil sands project. In July of the same year, Syncrude contracted with Allis-Chalmers for the purchase of 14 conveyor systems, including 4 extraction gearboxes. Both the Hunter and the Allis-Chalmers gearboxes were designed by Hunter U.S. in accordance with Bechtel specifications and fabricated by a subcontractor for Hunter U.S.

4 The gearboxes acquired from Hunter U.S. were put into service in July 1978. In September 1979, more than a year later, a gearbox failure occurred. The Allis-Chalmers extraction boxes went into operation in November 1977. In September 1979, nearly two years later, one of the extraction boxes failed and cracks were discovered in two of the other three.

5 The trial judge described the cause of the failure in these terms [pp. 62-63]:

> The outer rim of the bull gear is attached to the central shaft by steel plates, one on each side of the rim, called "web plates". Inside the outer rim a thicker portion of the rim provides a shoulder on each side. The intention was that the web plates be fitted snugly to the shoulder and welded in place. Halfway between the rim and the shaft eight 8-1/2 inch diameter holes were cut at regular intervals in line through each plate. Steel pipe was welded into each set of holes to provide rigid connections between the plates. At the outer edge of the web plates, where they met the inside of the rim, eight 3 inch radius "half moon" pieces were cut out at regular intervals. The result was that there was not a continuous weld attaching the web plates to the inside of the rim. The connection was broken in eight evenly spaced places by the 3 inch radius half moon cutouts.
>
> The bull gears failed because the weld between the web plates and the outer rim failed. The diagnosis was that the weld failed because of flexing of the web plates and that the web plates flexed because there was insufficient strength to withstand the torque applied by the pinion gear to the bull gear. The evidence supporting the flexing diagnosis was uneven wear and pitting of the teeth on the bull and pinion gears. The continuous flexing of the web plates

> weakened and cracked the weld between the web plate and the rim. In time, if remedial action had not been taken the web plates would have broken away entirely.

6 Syncrude was forced to undertake its own repairs to the gearboxes when Hunter U.S. and Allis-Chalmers refused warranty coverage. Syncrude and the other plaintiffs claimed damages from Hunter U.S. and from Allis-Chalmers for the cost of repairing and rebuilding the gearboxes, contending that the gearboxes were inherently defective, unsafe and unfit for the purposes for which they were intended and were not of merchantable quality. The defendants conceded that the gearboxes failed because they were too weak for the service, but they denied liability. By third party notice, Allis-Chalmers claimed contribution or indemnity from Hunter U.S. on the ground that if Allis-Chalmers were found liable, the liability would be due to faulty design or negligence by Hunter U.S.

7 Both the Hunter U.S. and the Allis-Chalmers contracts included a warranty limiting their liability to 24 months from the date of shipment or to 12 months from the date of start-up, whichever occurred first. In ad dition, the Allis-Chalmers warranty included a clause stating that the "Provisions of this paragraph represent the only warranty ... and no other warranty or conditions, statutory or otherwise shall be implied". Both the Hunter U.S. and Allis-Chalmers contracts provided that the laws of Ontario were to apply.

8 The trial judge noted that Hunter U.S. had designed the gearboxes and had drawn the plans and specifications for the internal working parts. He held that unless the Bechtel specifications provided to Hunter U.S. were inadequate, Hunter U.S. must take responsibility for the failures.

9 Hunter U.S. contended that there was no evidence led by Syncrude to show that the specifications were not met, to which the judge responded at p. 64:

> However, although the Canadian Bechtel specifications give detailed operating criteria for the gearboxes they do not extend to design details. Indeed, they expressly provide that: "Correct and adequate design is the seller's [sole] responsibility."
>
> In my opinion Hunter U.S. did not discharge the responsibility cast upon it when it accepted the Canadian Bechtel specifications. The torque applied by the pinion gear to the bull gear is directly related to the conveyor belt load which is translated into bull gear inertia which must be overcome by pinion gear force. The strength required in the moving parts within the gearbox to move the loaded conveyor belt is a design function and that design function was entirely the responsibility of Hunter U.S. The evidence was that the design load on the conveyor belt was never exceeded. The irresistible conclusion is that it was a design fault that prevented the gearboxes from performing the service. I so find.

10 The judgment of the Court of Appeal for British Columbia (reported 68 B.C.L.R. 367), affirmed the trial judge's finding that the cracks in the bull gears in the gearboxes were due to a breach of the design obligations of Hunter U.S. under its contract. The court awarded the sum of $1,000,000 against Hunter U.S., being the agreed cost, plus interest, of the repair of cracks in gears of the 32 mining gearboxes designed and supplied directly by Hunter U.S. to Syncrude.

11 The courts at trial and on appeal held that Hunter U.S. was not liable for the repair of the mining gearboxes under an express warranty because that warranty had expired. However, both courts also held that the cracks were in breach of the statutory warranty of reasonable fitness found in the Sale of Goods Act of Ontario.

12 Gibbs J. accepted Syncrude's argument that the Sale of Goods Act applied to the contract, barring express provisions to the contrary, and therefore held the implied warranty of fitness for purposes stipulated in s. 15(1) of that Act governed. Applying the three tests proposed by Professor Fridman in Sale of Goods in Canada, 2nd ed. (1979), at pp. 203-204, (i) that the contract be in the course of the seller's business; (ii) that the seller have knowledge of the purpose of the goods; (iii) and that the buyer rely on the seller's skill or judgment, the trial judge found Hunter U.S. liable to Syncrude for breach of s. 15(1).

13 In this court, Hunter U.S. submitted that its design responsibility was limited to providing the strength required by Bechtel's specifications, and that it was Bechtel's responsibility, as author of the specifications, to design to the strength required to move the loaded conveyor belt for the length of time Syncrude wanted the boxes to work without repair.

14 Paragraphs 21 and 22 of the Hunter U.S. factum read:

> 21. It must be emphasized that there is *no* evidence that Hunter's design did not provide a strength required by the specifications, and there is *no* evidence excluding an insufficiency in the strength required by the specifications as an alternative probable cause of the cracks when they eventually appeared.
>
> 22. In the result, the issue is one of proper interpretation of the contract: is Hunter's design obligation limited to designing in accordance with the strength required by the specifications? Or does it extend to and include the responsibility for designing to the strength required to move the loaded conveyor belt (without replacing a single gear) for more than twenty months of continuous service? If the former, the appeal succeeds entirely.

15 Counsel for Hunter U.S. quoted the design requirements set out in the specifications:

> **1.11 Requirements**
>
> The specifications, requirement drawings and date sheets included herewith represent minimum requirements.
>
> This Specification covers all engineering services required to complete the design *in accordance with the specifications.* Correct and adequate design is the Seller's sole responsibility. [emphasis by counsel]

and referred to cl. 10.2.4 of the specifications, headed "Service Factors":

> Gear reducers shall conform to AGMA standards for 1.5 mechanical service factor and 1:1 thermal service factor based on rated motor horsepower with motor service factor of 1.0. The mechanical rating shall permit loads of 275% of motor rated horsepower for starting and for momentary peak loads up to six occurrences per hour, and shall permit single starts at loads of 300 percent of motor rated horsepower (200 percent of reducer rating).

16 Syncrude took a somewhat different view of the matter, contending that the specifications were in fact drafted by Hunter U.S. and incorporated into the contract on the recommendation of Hunter U.S. Counsel submitted that it was necessary to review the history under which the contract specifications came into being. I will summarize that submission in the paragraphs immediately following.

17 The first oil sands plant built in the area of Fort McMurray, Alberta, was built by Great Canadian Oil Sands ("G.C.O.S.") in the early 1970's. In about 1972 Hunter U.S. designed and supplied the gearboxes and the conveyor system of G.C.O.S. The gearboxes supplied to G.C.O.S. were virtually identical in design to the gearboxes subsequently supplied to Syncrude. In 1974 Syncrude was in the planning stages for the construction of its plant. Hunter approached Syncrude and held itself out as being an expert in the design of gearboxes for the specific operation which Syncrude intended. Hunter U.S. supplied complete specifications for its gearboxes to Syncrude and represented that the specifications would be suitable for the particular purpose Syncrude intended.

18 The specifications gave various details regarding performance requirements of the gearboxes. However, they did not give any details of the dimensions of the components within the gearboxes. The service factors to which counsel for Hunter U.S. referred were taken directly from the original proposal of Hunter U.S. The mechanical service factor of 1.5 × horsepower, the thermal service factor of 1:1 and the mechanical rating of 275 per cent of motor rated horsepower for up to six starts per hour are all found in proposed specifications. There was nothing in the specifications which related to the part of the low speed gear which eventually failed.

19 Syncrude accepted the representations of Hunter U.S. as to its ability to produce suitable gearboxes for Syncrude's purpose and issued a purchase order to Hunter U.S. into which the specifications suggested by Hunter U.S., including the precise service factors, were incorporated.

20 Counsel for Syncrude also made the following additional points:

21 (i) the contract expressly provided, "Correct and adequate design is the Seller's sole responsibility";

22 (ii) Mr. Rao Duvurri, the design engineer employed by Hunter U.S., who designed the gearboxes for both G.C.O.S. and Syncrude and prepared detailed design drawings of all the components of the gearboxes for the purposes of manufacture, never discussed any of the matters relating to the design of the bull gear with Syncrude or Bechtel at any time;

23 (iii) the gearboxes should last 20 years; bull gears would normally be expected to last "10 years or beyond", yet Hunter U.S. conceded at para. 27 of its statement of facts that "There is no dispute that the strength of the moving parts within the gear boxes was inadequate to carry the conveyor belt for longer than two years without at least one failure";

24 (iv) Hunter U.S. called no expert witness, nor any evidence at all, except for certain extracts from the examination for discovery.

25 The following passage from the reasons of the trial judge at pp. 70-71, is apposite:

> ... on February 20, 1974 Hunter U.S., in the course of soliciting orders, sent Canadian Bechtel a technical description of their gearboxes, described as "shaft mounted conveyor drives". In the covering letter they said:
>
> > Furthering our telephone conversation of last week, I am attaching two (2) copies of Specifications for the 1250 HP, 60 RPM output gear reducers.
> >
> > Three Specifications are drawn up for installations in locations such as the Fort McMurray, Alberta Oil Sands Operation, and have been found quite suitable in other installations in that area.
> >
> > We have included the Ringfedar ring shaft mounting as you indicated, also.
> >
> > Please keep us informed on this project, and when you are in a position to accept prices for these units, we will be happy to respond with a minimum of delay.
>
> And in a summary sheet:
>
> > This specification is for a geared drive assembly designed to power a belt conveyor.
> >
> > This drive group has been designed for installation and operation in the remote areas and hostile environment normal to the mining industry. The units are designed for a high degree of reliability based on design arts developed in similar installations. Special design consideration has been made for field servicings in the event it is necessary.
>
> And on the introduction page of the descriptive document, described as "technical specifications":
>
> "This specification has been prepared to qualify HUNTER ENGINEERING COMPANY INC., as a competent and experienced manufacturer of specialized gear driving equipment.
>
> Hunter drives are designed for specific applications, incorporating those features required to minimize operational and environmental hazards having an adverse effect on the performance of the unit. Our market effort is directed towards those unique applications which challenge our designer's ingenuity. Hunter has the engineering,

> manufacturing and financial resources to supply the complete drive package designed to reliably power any defined processing function.

26 I am strongly of the opinion that upon its true construction the contract dated 29th January 1975, between Syncrude and Hunter U.S., places responsibility for the design of the gearboxes solely upon Hunter U.S., and that Hunter U.S. failed to discharge that responsibility. I would affirm the conclusions of the British Columbia courts on this point. I would reject the argument that Hunter U.S. had merely designed the gears according to specifications provided by Syncrude's agent and, therefore, if the specifications were inadequate, Syncrude was to blame. The words used in the contract clearly indicate a creative role for Hunter U.S. The specifications provided by Syncrude in the contract were specifications about what gearboxes were required to do, not how they were to be built. Specific design details were Hunter U.S.'s responsibility. There is no evidence that the specifications themselves were faulty; the evidence shows that the design was inadequate and design was solely Hunter U.S.'s responsibility.

27 Hunter U.S. knew the gearboxes were required to move a conveyor belt. Its tender to Syncrude of 20th February 1974 read in part:

> This specification is for a geared drive assembly designed to power a belt conveyor.

As Anderson J.A. observed in the Court of Appeal at p. 376:

> Hunter was well aware from the outset that the specifications were not to be construed in a vacuum but with regard to the system as a whole.

II The Contractual Warranty

28 In light of the design obligations of Hunter U.S., Syncrude attempts to rely on the contractual warranty provisions in both the Hunter U.S. and Allis-Chalmers contracts. Although the general clause is the same in both contracts, the warranty was modified differently in each document. Because the difference between these modifications is important for the statutory warranty argument, I include the entire text of the main provisions and the modifications. The general provision common to both contracts provided:

> 8. Warranties — Guarantees: Seller warrants that the goods shall be free from defects in design, material, workmanship, and title, and shall conform in all respects to the terms of this purchase order, and shall be of the best quality, if no quality is specified. If it appears within one year from the date of placing the equipment in service for the purpose for which it was purchased, that the equipment, or any part thereof, does not conform to these warranties and Buyer so notifies Seller within a reasonable time after its discovery, Seller shall thereupon promptly correct such nonconformity at its sole expense ... Except as otherwise provided in this purchase order, Seller's liability hereunder shall extend to all damages proximately caused by the breach of any of the foregoing warranties or guarantees, but such liability shall in no event include loss of profit or loss of use.

The clause was modified in the Hunter U.S. contract to read:

> Warranty: Twenty four (24) months from date of shipment to twelve (12) months from date of start-up whichever occurs first.

The Allis-Chalmers contract was modified to read:

> Warranty: 24 months from date of shipment or 12 months from date of start-up, whichever occurs first.
>
> Notes: Buyer's General Conditions supersede the Seller's Terms and Conditions of Sale and shall apply to this Purchase Order except as amended herein:
>
> **A. Paragraph 8 — "Warranties and Guarantees"**

> The final sentence of paragraph 8 is hereby deleted. In its place shall be, "The provisions of this paragraph represent the only warranty of the Seller and no other warranty or conditions, statutory or otherwise shall be implied." The warranty period shall be twelve (12) months from the date of operation or 24 months from the date of shipment, whichever occurs first ...

29 Two crucial factors emerge from these provisions. First, the relevant time period during which the warranties apply is 12 months from the date of putting the equipment into operation or 24 months from the date of shipment, whichever occurs first. Second, the Hunter U.S. provision does not exempt Hunter U.S. from warranties that arise from statutes.

30 The trial judge found the date of start-up to have been 4th July 1978. This was more than one year before the weakness in the gearboxes was first detected in September 1979. On this basis the trial judge rightly held that Syncrude was out of time and could not rely on the contractual warranty provisions.

31 Syncrude advances two arguments to suggest that it is entitled to rely on the contractual warranty. Both arguments are unconvincing and can be dismissed with little discussion. First, Syncrude alleges that the warranty clauses were not limited in time. It bases this claim on reading s. 8 as containing four distinct provisions. The first provision, contained in the first sentence, makes no mention of time and is therefore not limited in duration. This seems an incredible interpretation of a warranty provision. As a matter of contractual interpretation it makes sense to read the provision as a whole and not as four disjunctive parts.

32 The second argument is Syncrude's allegation that the defect "appeared" in the sense that the word is used in the warranty clause within the relevant time period. This claim rests on the allegations that the design defect "appeared" in the original drawings submitted by Hunter U.S. and that Hunter U.S. had knowledge of the defect before the gearboxes were operational. In response to this argument, the trial judge stated that Syncrude was proposing an extraordinary meaning of "appears", i.e., knowledge or deemed knowledge of Hunter U.S. The judge held that the word "appears" should be given its ordinary meaning, which is to become visible to Syncrude. This interpretation must be correct; any other interpretation would be stretching the meaning of the word beyond recognition.

The Implied Statutory Warranty

33 Since neither Hunter U.S. nor Allis-Chalmers could be held liable for breach of contractual warranty, the remaining option is to found liability on the basis of statutory warranty. The parties, an Alberta-based and an American-based company, had provided in the contract that the laws of Ontario were to apply. Syncrude contends that both Hunter U.S. and Allis-Chalmers breached s. 15(1) of the Ontario Sale of Goods Act, which reads:

> 15. Subject to this Act and any statute in that behalf, there is no implied warranty or condition as to the quality or fitness for any particular purpose of goods supplied under a contract of sale, except as follows:
>
> 1. *Where the buyer*, expressly or by implication, *makes known to the seller the particular purpose for which the goods are required* so as to show that the buyer relies on the seller's skill or judgment, and the goods are of a description that it is in the course of the seller's business to supply (whether he is the manufacturer or not), *there is an implied condition that the goods will be reasonably fit for such purpose*, but in the case of a contract for the sale of a specified article under its patent or other trade name there is no implied condition as to its fitness for any particular purpose. [emphasis added]

34 Section 53 of the Sale of Goods Act expressly provides for contracting out of the provisions of the Act. This may be accomplished by express agreement. Clearly the provision in the Allis-Chalmers contract reproduced above is sufficient to exclude the operation of the implied warranty.

35 The trial judge had no difficulty in concluding that, as against Hunter U.S., all three prerequisites for the application of s. 15(1) had been met. Hunter U.S. presents three arguments challenging this result. First, it submits that Syncrude

did not rely on Hunter's expertise as it was Syncrude which supplied the specifications. In light of the earlier finding concerning the nature of Hunter's design obligation, this argument cannot prevail. As the trial judge pointed out, Hunter U.S. could only succeed if there were evidence that Syncrude or Bechtel possessed and exercised skill and judgment in the design and manufacture of gearboxes. No such evidence was introduced.

36 Second, Hunter U.S. argues that because the gearboxes worked for more than one year, they *were* reasonably fit for their purpose. This seems difficult to accept when, as Syncrude contends, a gearbox is expected to operate without problem for more than ten years. I fail to understand how anything as seriously flawed as the gearboxes in the case at bar could be said to be reasonably fit.

37 Finally, Hunter U.S. argues that Syncrude cannot rely on the statutory warranty because it is inconsistent with the warranty embodied in the contract. According to s. 15(4) of the Sale of Goods Act, an implied condition can be negatived by an express warranty if the two are inconsistent. As mentioned earlier, s. 53 also allows parties to contract out of the provisions of the Act. Hunter U.S.'s argument is that the very presence of the express warranty renders the statutory warranty inapplicable. Again, this cannot be the correct position. The mere presence of an express warranty in the contract does not mean that the statutory warranties are inconsistent. If one wishes to contract out of statutory protections, this must be done by clear and direct language, particularly where the parties are two large, commercially sophisticated companies. This seems to be well-established in the case law, as Eberle J. makes clear in *Chabot v. Ford Motor Co. of Can.* (1982), 39 O.R. (2d) 162, 19 B.L.R. 147, 22 C.C.L.T. 185, 138 D.L.R. (3d) 417 (H.C.).

38 I would adopt the following passage from the reasons of Gibbs J. at trial at p. 73:

> Hunter U.S. cannot avoid liability under s. 15 §1 of the Ontario Sale of Goods Act. The design and manufacture of the gearboxes was in the course of Hunter U.S. business activities. Hunter U.S. knew the purpose of the gearboxes. Syncrude, through its agent, relied upon the skill and judgment of Hunter U.S. The gearboxes were not reasonably fit for the purpose for which they were required. Hunter U.S. is in breach of the implied condition in s. 15 §1.

IV Fundamental Breach

39 It will now be convenient to consider the liability to Syncrude of Allis-Chalmers and in turn of Hunter U.S. on the third party claim of Allis-Chalmers. The facts can be briefly stated. The purchase agreement contained in para. 8 a warranty modified, as stated earlier, to exclude statutory warranties or conditions. Paragraph 14 of the agreement read:

> **C. Paragraph 14 — Limitation of Liability**
>
> Notwithstanding any other provision in this contract or any applicable statutory provisions neither the Seller nor the Buyer shall be liable to the other for special or consequential damages or damages for loss of use arising directly or indirectly from any breach of this contract, fundamental or otherwise or from any tortious acts or omissions of their respective employees or agents and in no event shall the liability of the Seller exceed the unit price of the defective product or of the product subject to late delivery.

40 The price of the 14 conveyor systems and accessories purchased from Allis-Chalmers was $4,166.464. The agreed cost of the repairs was $400,000; including prejudgment interest, $535,000. In the face of the contractual provisions, Allis-Chalmers can only be found liable under the doctrine of fundamental breach.

41 The Court of Appeal differed with the trial judge on the question of fundamental breach. At trial Gibbs J., at pp. 74-76, quoted with approval from the judgment of Stratton J.A. (as he then was) in *Sperry Rand Can. Ltd. v. Thomas Equip. Ltd.* (1982), 135 D.L.R. (3d) 197, 40 N.B.R. (2d) 271, 105 A.P.R. 271 at 205-206 (C.A.), and the judgment of Harradence J.A. in *Gafco Ent. Ltd. v. Schofield*, [1983] 4 W.W.R. 135 at 139-41, 25 Alta. L.R. (2d) 238, 23 B.L.R. 9, 43 A.R. 262 (C.A.).

42 Applying the principle of these cases to the purchase order and the nature of the defect in the bull gears, Gibbs J. concluded that the case for fundamental breach had not been made out. He said at pp. 77-78:

> As to the nature of the defect, in my opinion it was not so fundamental that it went to the root of the contract. The contract between the parties was still a contract for gearboxes. Gearboxes were supplied. They were capable of performing their function and did perform it for in excess of a year which, given the agreed time limitations, as the "cost free to Syncrude" period contemplated by the parties. It was conceded that the gearboxes were not fit for the service. However, the unfitness, or defect, was repairable and was repaired at a cost significantly less than the original purchase price. No doubt the bull gear is an important component of the gearbox but no more important than the engine in an automobile and in the *Gafco Ent.* case the failure of the engine was not a sufficiently fundamental breach to lead the Court to set aside the contract of sale. On my appreciation of the evidence Syncrude got what it bargained for ... It has not convinced me that there was fundamental breach.

43 On appeal, Anderson J.A. reviewed a number of authorities including the judgment of Seaton J.A. in *Beldessi v. Island Equip. Ltd.* (1973), 41 D.L.R. (3d) 147 (B.C.C.A.), and held that Allis-Chalmers was in fundamental breach because Syncrude was deprived of substantially the whole benefit of the contract.

44 In reaching that conclusion, he said at p. 393:

> It follows that the cost of repair was not significantly less than the original purchase price but, on the contrary, the cost of repair constituted 86 per cent of the purchase price. Moreover, the expected life of a gearbox is 20 years. The expected life of a bull gear is at least 10 years. The bull gear failed within less than two years after Syncrude's operations commenced.

He rejected as without merit the argument of counsel for Allis-Chalmers that Syncrude's contract with Allis-Chalmers was not just a "contract for gearboxes" but was rather a contract for the purchase of a package of 14 conveyor systems for a price of over $4,000,000, and viewed in relation to the total purchase price actually paid by Syncrude, the cost of repair of one component, whether it is considered to be the bull gear or the gearbox, was indeed "significantly less than the original purchase price".

45 Hunter U.S., ultimately liable on account of the third party claim against it, submits that the British Columbia Court of Appeal was wrong on this branch of the case because the effect of its decision is to re-establish the doctrine of fundamental breach as a rule of law invalidating a clause limiting liability.

46 Counsel submits that in England, since *Suisse Atl. Soc. d'Armement Maritime S.A. v. N.V. Rotterdamsche Kolen Centrale*, [1967] 1 A.C. 361, [1966] 2 W.L.R. 944, [1966] 2 All E.R. 61 (H.L.), the doctrine of fundamental breach has been rejected as a rule of law invalidating exemption clauses. At p. 405, Lord Reid said: "In my view no such rule of law ought to be adopted". In commenting upon that decision, Professor P.S. Atiyah in his text, The Sale of Goods, 6th ed. (1980), at p. 157, says "This was not in all respects an easy decision to understand ..." With that statement I am in full agreement. Professor Atiyah continues:

> ... but the principal point to emerge from the *Suisse Atlantique* case was the firm and unanimous holding that the "doctrine" of fundamental breach is not a rule of law but merely a rule of construction. Parties are free to make whatever provision they desire in their contracts, but it is a rule of construction that an exemption clause does not protect a party from liability for fundamental breach. It follows that if the contract by express provision does protect a party from such a result and the court thinks that the provision was intended to operate in the circumstances which have occurred, the provision must be given full effect.

47 It was contended by Hunter U.S. that, at bar, the Court of Appeal approached the matter by asking whether the warranty in the contract excluded liability for fundamental breach. Upon finding it did not, the Court of Appeal then

found as a fact, contrary to the finding of fact made by the trial judge, that the breach was fundamental, and awarded the buyer the full amount of its claim.

48 It was submitted that by doing this, the Court of Appeal erroneously adopted the approach (as it did in *Beldessi v. Island Equip. Ltd.*, supra, upon which it relied so heavily in this case) that to be effective a limitation of liability clause must expressly exclude liability for fundamental breach. It was submitted this approach involves returning to the notion of treating fundamental breach as something which, as a rule of law, will displace the terms of the contract; to paraphrase Lord Bridge's decision in *George Mitchell (Chesterhall) Ltd. v. Finney Lock Seeds Ltd.*, [1983] 2 A.C. 803, [1983] 3 W.L.R. 163, [1983] 2 All E.R. 737 at 741 (H.L.): it reintroduces by the back door a doctrine which the *Suisse Atl.* case, and cases following, had evicted by the front.

49 Allis-Chalmers adopted in its entirety the argument of Hunter U.S. with respect to the fundamental breach issue. The argument in the factum of Allis-Chalmers was directed to the further question whether the Court of Appeal erred in failing to construe properly the warranty clause in ascertaining whether it applied to the instant breach.

50 Allis-Chalmers argued that the words of cl. 8 are clear and fairly susceptible of only one meaning, and the Court of Appeal erred in failing to give effect to them; instead of giving effect to the language of the contract, the Court of Appeal imported its own implied warranty and erroneously embarked on a consideration of whether cl. 8 was effective to eliminate the "essential undertaking of Allis-Chalmers to provide gearboxes capable of meeting the requirements of the extraction process". In proceeding in this fashion, the Court of Appeal in effect resurrected a term analogous to the implied statutory warranty of fitness for the purpose required, which the parties had expressly excluded. By importing this additional term into the contract, the court rewrote the bargain which the parties had made for themselves.

51 Syncrude argues in response that the seller's fundamental obligation does not derive from, and is not dependent upon, the existence of express or implied warranties or conditions. It is inherent in the contract of sale.

52 Syncrude relied upon the pronouncement of the doctrine of fundamental obligation of the seller enunciated by Weatherston J. in *Cain v. Bird Chevrolet-Oldsmobile Ltd.* (1976), 12 O.R. (2d) 532, 69 D.L.R. (3d) 484, affirmed 20 O.R. (2d) 569, 88 D.L.R.(3d) 607 (C.A.). The court stated at pp. 534-35:

> The first and most important thing in any case is to determine what are the terms of the contract, so as to decide what performance was required by the defaulting party ...
>
> Where a machine has been delivered which has such a defect, or "such a congeries of defects" as to destroy the workable character of the machine, there is said to be a fundamental breach of contract by the seller. This is so because the purported performance of the contract is quite different than that which the contract contemplated ... There has been no failure of consideration, no failure to deliver the thing contracted for, but it is implicit in the transaction, as a fundamental term, that the thing contracted for is what it seems to be.

53 The House of Lords cases decided that liability for breach of a fundamental term may be excluded by a suitably worded exclusion clause. However, counsel contended that there is a rule of construction that exemption clauses must be very clearly worded if they are to be sufficient to exclude liability for fundamental breach. It was said that this approach to the construction of a contract was confirmed in this court in *Beaufort Realties (1964) Inc. v. Chomedey Aluminum Co.*, [1980] 2 S.C.R. 718, 15 R.P.R. 62, 116 D.L.R. (3d) 193, (sub nom. *Beaufort Realties (1964) Inc. v. Belcourt Const. (Ottawa) Ltd.)* 33 N.R. 460 [Ont.].

54 On the application of the principles to the present case, Syncrude asked the question whether Allis-Chalmers and Syncrude intended that Allis-Chalmers could supply gearboxes which were so fundamentally defective as to require complete replacement, or in this case, complete reconstruction, after 15 months' service, at Syncrude's sole cost. Syncrude would give a negative response to this question.

55 I have had the advantage of reading the reasons for judgment prepared by my colleague, Justice Wilson, in this appeal and I agree with her disposition of the liability of Allis-Chalmers. In my view, the warranty clauses in the Allis-Chalmers contract effectively excluded liability for defective gearboxes after the warranty period expired. With respect, I disagree, however, with Wilson J.'s approach to the doctrine of fundamental breach. I am inclined to adopt the course charted by the House of Lords in *Photo Production Ltd. v. Securicor Tpt. Ltd.*, [1980] A.C. 827, [1980] 2 W.L.R. 283, [1980] 1 All E.R. 556, and to treat fundamental breach as a matter of contract construction. I do not favour, as suggested by Wilson J., requiring the court to assess the reasonableness of enforcing the contract terms after the court has already determined the meaning of the contract based on ordinary principles of contract interpretation. In my view, the courts should not disturb the bargain the parties have struck, and I am inclined to replace the doctrine of fundamental breach with a rule that holds the parties to the terms of their agreement, provided the agreement is not unconscionable.

56 The doctrine of fundamental breach in the context of clauses excluding a party from contractual liability has been confusing at the best of times. Simply put, the doctrine has served to relieve parties from the effects of contractual terms, excluding liability for deficient performance where the effects of these terms have seemed particularly harsh. Lord Wilberforce acknowledged this in *Photo Production*, supra, at p. 843:

> 1. The doctrine of "fundamental breach" in spite of its imperfections and doubtful parentage has served a useful purpose. There was a large number of problems, productive of injustice, in which it was worse than unsatisfactory to leave exception clauses to operate.

In cases where extreme unfairness would result from the operation of an exclusion clause, a fundamental breach of contract was said to have occurred. The consequence of fundamental breach was that the party in breach was not entitled to rely on the contractual exclusion of liability but was required to pay damages for contract breach. In the doctrine's most common formulation, by Lord Denning in *Karsales (Harrow) Ltd. v. Wallis*, [1956] 1 W.L.R. 936, [1956] 2 All E.R. 866 (C.A.), fundamental breach was said to be a rule of law that operated regardless of the intentions of the contracting parties. Thus, even if the parties excluded liability by clear and express language, they could still be liable for fundamental breach of contract. This rule of law was rapidly embraced by both English and Canadian courts.

57 A decade later in the *Suisse Atl.* case, the House of Lords rejected the rule of law concept in favour of an approach based on the true construction of the contract. The Law Lords expressed the view that a court considering the concept of fundamental breach must determine whether the contract, properly interpreted, excluded liability for the fundamental breach. If the parties clearly intended an exclusion clause to apply in the event of fundamental breach, the party in breach would be exempted from liability. In *B.G. Linton Const. Ltd. v. C.N.R.*, [1975] 2 S.C.R. 678, [1975] 3 W.W.R. 97, 49 D.L.R. (3d) 548, 3 N.R. 151 [Alta.], this court approved of the *Suisse Atl.* formulation. The renunciation of the rule of law approach by the House of Lords and by this court, however, had little effect on the practice of lower courts in England or in Canada. Lord Denning quickly resuscitated the rule of law doctrine in *Harbutt's "Plasticine" Ltd. v. Wayne Tank & Pump Co.*, [1970] 1 Q.B. 447, [1970] 2 W.L.R. 198, [1970] 1 All E.R. 225 (C.A.).

58 Finally, in 1980, the House of Lords definitively rejected the rule of law approach to fundamental breach in *Photo Production*, supra. In that case, the plaintiff Photo Production had contracted with Securicor, a company in the business of supplying security services, to provide four nightly patrols of its factory. At issue was whether Securicor was liable for a fire deliberately set by one of its employees in the course of his duties at the Photo Production factory. The contract between the two parties contained the following limitation clause (at p. 840):

> Under no circumstances shall the company (Securicor) be responsible for any injurious act or default by any employee of the company unless such act or default could have been foreseen and avoided by the exercise of due diligence on the part of the company as his employer; nor, in any event, shall the company be held responsible for (a) any loss suffered by the customer through burglary, theft, fire or any other cause, except insofar as such loss is solely attributable to the negligence of the company's employees acting within the course of their employment ...

The limitation clause clearly excluded liability for fire with the exception of fires started by negligent acts. Securicor argued it could not be liable under the contract for the fire that occurred. Photo Production contended that Securicor was liable for the damage done to the factory under the doctrine of fundamental breach.

59 Lord Wilberforce rejected Photo Production's argument. He began by reviewing the fractured history of the doctrine of fundamental breach and then forcefully repudiated the rule of law concept. Lord Wilberforce reiterated the thoughts articulated in *Suisse Atl.*, stating at pp. 842-43, he had no doubt as to:

> ... the main proposition that the question whether and to what extent, an exclusion clause is to be applied to a fundamental breach, or a breach of a fundamental term, or indeed to any breach of contract, is a matter of construction of the contract.

The policy behind this approach is stated by Lord Wilberforce at p. 843 as follows:

> At the stage of negotiation as to the consequences of a breach, there is everything to be said for allowing the parties to estimate their respective claims according to the contractual provisions they have themselves made, rather than for facing them with a legal complex so uncertain as the doctrine of fundamental breach must be ...
>
> At the judicial stage there is still more to be said for leaving cases to be decided straightforwardly on what the parties have bargained for rather than upon analysis, which becomes progressively more refined, of decisions in other cases leading to inevitable appeals.

Lord Wilberforce proceeded to examine the contract between Securicor and Photo Production to determine exactly what the parties had provided, at p. 846:

> As a preliminary, the nature of the contract has to be understood. Securicor undertook to provide a service of periodical visits for a very modest charge ... It would have no knowledge of the value of the plaintiffs' factory: that, and the efficacy of their fire precautions, would be known to the respondents. In these circumstances nobody could consider it unreasonable, that as between these two equal parties the risk assumed by Securicor should be a modest one, and that the respondents should carry the substantial risk of damage or destruction.
>
> The duty of Securicor was, as stated, to provide a service. There must be implied an obligation to use due care in selecting their patrolmen, to take care of the keys and, I would think, to operate the service with due and proper regard to the safety and security of the premises. The breach of duty committed by Securicor lay in a failure to discharge this latter obligation. Alternatively it could be put upon a vicarious responsibility for the wrongful act ... This being the breach, does condition 1 apply? It is drafted in strong terms, "Under no circumstances" ... "any injurious act or default by any employee." *These words have to be approached with the aid of the cardinal rules of construction that they must be read contra proferentem and that in order to escape from the consequences of one's own wrongdoing, or that of one's servant, clear words are necessary. I think that these words are clear.* The respondents in facts [sic] relied upon them for an argument that since they exempted from negligence they must be taken as not exempting from the consequence of deliberate acts. But this is a perversion of the rule that if a clause can cover something other than negligence, it will not be applied to negligence. *Whether, in addition to negligence, it covers other, e.g., deliberate, acts, remains a matter of construction requiring, of course, clear words. I am of opinion that it does, and being free to construe and apply the clause, I must hold that liability is excluded.* [emphasis added]

60 Lord Diplock alluded to the importance of negotiated risk allocation at p. 851:

> My Lords, the reports are full of cases in which what would appear to be very strained constructions have been placed upon exclusion clauses, mainly in what to-day would be called consumer contracts and contracts of adhesion ... In commercial contracts negotiated between business-men capable of looking after their own interests and of deciding how risks inherent in the performance of various kinds of contract can be most economically borne (generally by

> insurance), it is, in my view, wrong to place a strained construction upon words in an exclusion clause which are clear and fairly susceptible of one meaning only even after due allowance has been made for the presumption in favour of the implied primary and secondary obligations.

61 In *Beaufort Realties (1964) Inc.*, supra, Ritchie J., delivering the judgment of this court, stated at p. 723:

> Stated bluntly, the difference of opinion as to the true intent and meaning of their Lordships' judgment in the *Suisse Atlantique* case centered around the question of whether a rule of law exists to the effect that a fundamental breach going to the root of a contract eliminates once and for all the effect of all clauses exempting or excluding the party in breach from rights which it would otherwise have been entitled to exercise, or whether the true construction of the contract is the governing consideration in determining whether or not an exclusionary clause remains unaffected and enforceable notwithstanding the fundamental breach. The former view was espoused by Lord Denning and is illustrated by his judgment which he delivered on behalf of the Court of Appeal in the *Photo Production* case (*supra*) ...

and at p. 725:

> It has been concurrently found by the learned trial judge and the Court of Appeal that article 6 of this contract constituted an exclusionary or exception clause and Madame Justice Wilson adopted the same considerations as those which governed the House of Lords in the *Photo* case in holding that the question of whether such a clause was applicable where there was a fundamental breach was to be determined according to the true construction of the contract. I concur in this approach to the case.

62 As Wilson J. notes in her reasons, Canadian courts have tended to pay lip service to contract construction but to apply the doctrine of fundamental breach as if it were a rule of law. While the motivation underlying the continuing use of fundamental breach as a rule of law may be laudatory, as a tool for relieving parties from the effects of unfair bargains, the doctrine of fundamental breach has spawned a host of difficulties; the most obvious is how to determine whether a particular breach is fundamental. From this very first step the doctrine of fundamental breach invites the parties to engage in games of characterization, each party emphasizing different aspects of the contract to show either that the breach that occurred went to the very root of the contract or that it did not. The difficulty of characterizing a breach as fundamental for the purposes of exclusion clauses is vividly illustrated by the differing views of the trial judge and the Court of Appeal in the present case.

63 The many shortcomings of the doctrine as a means of circumventing the effects of unfair contracts are succinctly explained by Professor Waddams (The Law of Contracts, 2nd ed. (1984), at pp. 352-53):

> The doctrine of fundamental breach has, however, many serious deficiencies as a technique of controlling unfair agreements. The doctrine requires the court to identify the offending provision as an "exemption clause", then to consider the agreement apart from the exemption clause, to ask itself whether there would have been a breach of that part of the agreement and then to consider whether that breach was "fundamental". These inquiries are artificial and irrelevant to the real questions at issue. An exemption clause is not always unfair and there are many unfair provisions that are not exemption clauses. It is quite unsatisfactory to look at the agreement apart from the exemption clause, because the exemption clause is itself part of the agreement, and if fair and reasonable a perfectly legitimate part. Nor is there any reason to associate unfairness with breach or with fundamental breach ...
>
> More serious is the danger that suppression of the true criterion leads, as elsewhere, to the striking down of agreements that are perfectly fair and reasonable.

Professor Waddams makes two crucially important points. One is that not all exclusion clauses are unreasonable. This fact is ignored by the rule of law approach to fundamental breach. In the commercial context, clauses limiting or excluding liability are negotiated as part of the general contract. As they do with all other contractual terms, the parties bargain for the consequences of deficient performance. In the usual situation, exclusion clauses will be reflected in the

contract price. Professor Waddams' second point is that exclusion clauses are not the only contractual provisions which may lead to unfairness. There appears to be no sound reason for applying special rules in the case of clauses excluding liability than for other clauses producing harsh results.

64 In light of the unnecessary complexities the doctrine of fundamental breach has created, the resulting uncertainty in the law, and the unrefined nature of the doctrine as a tool of averting unfairness, I am much inclined to lay the doctrine of fundamental breach to rest, and where necessary and appropriate, to deal explicitly with unconscionability. In my view, there is much to be gained by addressing directly the protection of the weak from overreaching by the strong, rather than relying on the artificial legal doctrine of "fundamental breach". There is little value in cloaking the inquiry behind a construct that takes on its own idiosyncratic traits, sometimes at odds with concerns of fairness. This is precisely what has happened with the doctrine of fundamental breach. It is preferable to interpret the terms of the contract, in an attempt to determine exactly what the parties agreed. If on its true construction the contract excludes liability for the kind of breach that occurred, the party in breach will generally be saved from liability. Only where the contract is unconscionable, as might arise from situations of unequal bargaining power between the parties, should the courts interfere with agreements the parties have freely concluded. The courts do not blindly enforce harsh or unconscionable bargains and, as Professor Waddams has argued, the doctrine of "fundamental breach" may best be understood as but one manifestation of a general underlying principle which explains judicial intervention in a variety of contractual settings. Explicitly addressing concerns of unconscionability and inequality of bargaining power allows the courts to focus expressly on the real grounds for refusing to give force to a contractual term said to have been agreed to by the parties.

65 I wish to add that, in my view, directly considering the issues of contract construction and unconscionability will often lead to the same result as would have been reached using the doctrine of fundamental breach, but with the advantage of clearly addressing the real issues at stake.

66 In rejecting the doctrine of fundamental breach and adopting an approach that binds the parties to the bargains they make, subject to unconscionability, I do not wish to be taken as expressing an opinion on the substantial failure of contract performance, sometimes described as fundamental breach, that will relieve a party from future obligations under the contract. The concept of fundamental breach in the context of refusal to enforce exclusion clauses and of substantial failure of performance have often been confused, even though the two are quite distinct. In *Suisse Atl.*, Lord Wilberforce noted the importance of distinguishing the two uses of the term fundamental breach, at p. 431:

> Next for consideration is the argument based on "fundamental breach" or, which is presumably the same thing, a breach going "to the root of the contract." These expressions are used in the cases to denote two quite different things, namely (i) a performance totally different from that which the contract contemplates, (ii) a breach of contract more serious than one which would entitle the other party merely to damages and which (at least) would entitle him to refuse performance or further performance under the contract.
>
> Both of these situations have long been familiar in the English law of contract ... What is certain is that to use the expression without distinguishing to which of these, or to what other, situations it refers is to invite confusion.
>
> The importance of the difference between these meanings lies in this, that they relate to two separate questions which may arise in relation to any contract.

I wish to be clear that my comments are restricted to the use of fundamental breach in the context of enforcing contractual exclusion clauses.

67 Turning to the case at bar, I am of the view that Allis-Chalmers is not liable for the defective gearboxes. The warranty provision of the contract between Allis-Chalmers and Syncrude clearly limited the liability of Allis-Chalmers to defects appearing within one year from the date of placing the equipment into service. The trial judge found that the defects in the gearboxes did not become apparent until after the warranty of Allis-Chalmers had expired. It is clear, therefore, that the warranty clause excluded liability for the defects that materialized, and subject to the existence of any

unconscionability between the two parties there can be no liability on the part of Allis-Chalmers. I have no doubt that unconscionability is not an issue in this case. Both Allis-Chalmers and Syncrude are large and commercially sophisticated companies. Both parties knew or should have known what they were doing and what they had bargained for when they entered into the contract. There is no suggestion that Syncrude was pressured in any way to agree to terms to which it did not wish to assent. I am therefore of the view that the parties should be held to the terms of their bargain and that the warranty clause freed Allis-Chalmers from any liability for the defective gearboxes.

V The Trust Agreement

68 In 1977, almost three years after it originally contracted with Hunter U.S. for gearboxes, Syncrude determined it required an additional 11 gearboxes. It was approached by individuals with whom it had previously dealt at Hunter U.S., who said they now represented the Canadian subsidiary of Hunter U.S., Hunter Machinery (Canada) Limited ("Hunter Canada"). In fact, Hunter Canada was incorporated independently by employees of Hunter U.S. and the president of Aco Sales and Engineering ("Aco"), a subcontractor used by Hunter U.S. It had no connection with Hunter U.S. All representations that Hunter Canada was in any way affiliated with Hunter U.S. amounted to fraudulent misrepresentations.

69 Unaware of the fraud being perpetrated by Hunter Canada, Syncrude contracted with Hunter Canada for the purchase of the 11 gearboxes in the fall of 1977. The gearboxes were to be of the same design as the original 32 mining gearboxes. The only noteworthy feature of the contract was the warranty provision which was significantly broader than that normally negotiated by Hunter U.S. Unlike the Hunter U.S. warranty which was limited in time, the Hunter Canada warranty was unlimited in time.

70 Hunter Canada subcontracted with Aco for the manufacture of the gearboxes. After Aco had commenced work on the gearboxes but before Syncrude had made any payments to Hunter Canada under the contract, Hunter U.S. discovered Hunter Canada's deception. Hunter U.S. immediately alerted Syncrude and, on 13th January 1978, commenced a "passing off" action against Hunter Canada and the individuals who owned Hunter Canada. Syncrude, in the meantime, had an urgent need for the additional gearboxes. The gearboxes were essential for its operation and Syncrude was very concerned that receipt of the gearboxes would be held up until judgment in the passing off action. In January 1978 Syncrude secured a waiver from Hunter Canada of any right, title or interest arising from the contract, subject to the creation of a trust agreement acceptable to Hunter Canada.

71 On 1st March 1978, in an attempt to ensure prompt delivery of the gearboxes, Syncrude entered into two agreements. In the first agreement, Aco agreed to manufacture gearboxes for Syncrude at the price it would have received from Hunter Canada. Aco, it should be said, had already begun production of gearboxes under the Hunter Canada subcontract. The second agreement between Syncrude and one Donald E. Mann and Aco, appended as a schedule to the first, established a trust fund. All moneys that would have been payable by Syncrude to Hunter Canada were to be paid into the trust fund and administered by Mann as trustee. Aco was to be paid the contract price out of the fund. The balance was to be dealt with as follows:

> 7. Following the payments made pursuant to clauses 5 and 9, the trustee shall hold the remainder of the trust funds and trust income for payment pending determination by agreement between Hunter Canada and Hunter Engineering, or by a decision of a Court of competent jurisdiction in Canada as to the identity of the holder of a valid and lawful interest in the remainder of trust funds as between Hunter Engineering and Hunter Canada, or upon determination of certain issues in Canada, currently the subject of legal proceedings between Hunter Engineering and Hunter Canada by settlement agreement or by a decision of a Court of competent jurisdiction in Canada.
>
> 8. The trustee shall pay from the remainder of the trust fund at such time as the holder of a valid interest in the trust fund is determined pursuant to Clause 7, above, an amount or portion of the remainder of the trust fund which represents the value of such valid interest to the holder as identified, being an amount no more than the value of the interest Hunter Canada would have had under the purchase orders identified in Schedule "A" of the said Agreement

> less any payments made pursuant to Clauses 5 and 9 hereof; provided, however, the trustee shall refrain from making any such payment of the said remainder of the trust fund and trust income until the holder of the valid and lawful interest in the trust fund has undertaken, by agreement with Syncrude, to assume warranty and service obligations with respect to the Work under the said Agreement, as provided expressly or impliedly by the provisions of the purchase orders identified in Schedule "A" thereto, and until the trustee is notified by Syncrude of such agreement.
>
> 9. Reasonable legal expenses incurred by the trustee in the performance of his duties herein and remuneration to the trustee in accordance with the provisions of The Trustee Act shall be paid from the remainder of the trust funds following payments made pursuant to Clause 5.
>
> 10. In the event that Syncrude and the holder of the valid and lawful interest in the trust fund are unable to agree with respect to the warranty and service of Work in Schedule "A" of the said Agreement, the trustee shall pay the remainder of the trust fund, as determined by Clause 7 and Clause 8 of this Agreement, to Syncrude.
>
> 11. Upon satisfaction of the payments provided in Clauses 5, 7, 8 and 9 hereto, the trustee shall pay the balance of the remainder of the trust fund, if any, and trust income to Syncrude.

72 It will be noted that an amount representing the profit Hunter Canada would have made, less the administration costs of the trust fund, was to be payable from the trust fund to the successful party in the litigation between Hunter U.S. and Hunter Canada, provided that party agreed to assume the Hunter Canada warranty and service obligations. By the express terms of the trust agreement, Syncrude was entitled to the interest (the trust income) on the principal of the trust. Both Hunter U.S. and Hunter Canada had knowledge of the two agreements mentioned. Neither was a party to the Aco agreement or to the trust agreement.

73 The full scope of the discussions between Hunter U.S. and Syncrude during this period is unclear. The trial judge found that Hunter U.S. was prepared to assume warranty and service obligations if Syncrude repudiated its obligations under the Hunter Canada contract and contracted directly with it. Syncrude disputes this finding and claims that the discussions were limited to the creation of the trust fund. In my view, whether or not Hunter U.S. offered to assume the Hunter Canada contract is immaterial to the outcome of this appeal because it is clear that by the time the two agreements were entered into, Hunter U.S. was no longer willing to assume the Hunter Canada warranty provisions. Hunter U.S. continued to maintain the position, in the present proceedings, that it was not bound by the terms of the trust agreement and not obliged to honour any warranty or service obligations as a condition of payment to it of the trust moneys. Paragraph 25C(i) of the further amended statement of defence and counterclaim of Hunter U.S. reads:

> Further and in any event this Defendant says the Plaintiff is a constructive trustee of the monies in the Trust Fund for this Defendant and this Defendant is not bound by the terms of the Trust Agreement and is not obliged to honour any warranty or service obligations as a condition of payment to it of the trust monies in view of all the circumstances of this case being those recited herein together with the fact the Plaintiff accepted certain warranty and service obligations from Aco and Hunter Canada in respect of the gearboxes and enforced or attempted to enforce the same against Aco and Hunter Canada.

74 The trust fund now contains the profit Hunter Canada would have made, plus interest on the amount of this principal. Hunter U.S. claims it is entitled to all moneys in the trust fund under the doctrine of constructive trust. This amount is significantly greater than the amount Hunter U.S. could have claimed under the express terms of the trust fund had Hunter U.S. complied with its terms.

75 Judgment was given in favour of Hunter U.S. in the passing off action in December 1978. Meredith J. held that as between Hunter U.S. and Hunter Canada, Hunter U.S. was entitled to the trust fund. Syncrude was not, however, a party to that action. Also, it is important to note that the judgment provided that Hunter U.S.'s entitlement was conditional upon Hunter U.S. assuming warranty and service obligations, which it declined to assume.

76 The balance in the trust fund, when the trial began, was approximately $420,000. The gearboxes which were the subject of the Hunter Canada purchase orders underwent repair and rebuilding at a cost to Syncrude of $200,000, inclusive of prejudgment interest. That cost would have been covered by the warranty in the Hunter Canada purchase orders.

77 At trial, Gibbs J. rejected the claim of Hunter U.S. under the head of constructive trust. He said at pp. 81-82:

> In my opinion, the entitlement to the trust moneys is to be determined solely in accordance with the terms of the trust agreement. Hunter U.S. claimed entitlement under the doctrines of constructive trust and unjust enrichment, sometimes called restitutionary proprietary claims, but it cannot succeed on those grounds. The indicia are not present. Prior to the creation of the trust, there was not that nexus between the parties that is found in the reported cases on restitutionary proprietary claims. There was no fiduciary relationship between Syncrude and Hunter U.S.; there had not been a payment of money or delivery of property by Hunter U.S. to Syncrude under circumstances where it would be against conscience for Syncrude to retain it; Hunter U.S. was not a party with Syncrude to any agreement which gave Hunter U.S. a claim on Syncrude's funds. Hunter U.S. had, and established, a claim against Hunter Canada. If Syncrude had paid the purchase price to Hunter Canada, on the authorities, Hunter U.S. could have recovered the profit element from Hunter Canada because of the fiduciary duty owed to Hunter U.S. by those of its employees who were the owners of Hunter Canada. In my opinion however, in the absence of the trust agreement, Hunter U.S. would have no claim against Syncrude. It had not contracted with Syncrude, nor had it provided any of those things for which profit stands as compensation, such as risk capital, skilled and knowledgeable staff, supervision, overhead, and like matters. None of its plant or personnel had been used. I am satisfied that if Hunter U.S. has an entitlement, it must be found within the four corners of the trust agreement.

78 It will be observed from the foregoing passage that the trial judge was of the opinion that entitlement to the trust moneys had to be determined solely in accordance with the terms of the trust agreement. In his view, none of the indicia of restitutionary proprietary claims was present. He awarded Syncrude the trust income and awarded the principal of the trust to Hunter U.S. on the condition that it assume the warranty obligations of Hunter Canada before 1st October 1984. That date, by order of Gibbs J., dated 17th September 1984, was later extended to the date which is two months after final judgment in appeal had been handed down.

79 The Court of Appeal reversed the decision of the trial judge. The court held that the issue fell to be determined by reference to the judgment of this court in *Pettkus v. Becker*, [1980] 2 S.C.R. 834, 19 R.F.L. (2d) 165, 8 E.T.R. 143, 117 D.L.R. (3d) 257, 34 N.R. 384 [Ont.]. Anderson J.A. was of the opinion that the criteria necessary to establish a successful claim for unjust enrichment, namely, (1) an enrichment of the defendant; (2) a corresponding deprivation of the plaintiff; and (3) the absence of a juristic reason for the enrichment, were satisfied.

80 The Court of Appeal held that if Syncrude were to keep the trust income, Syncrude would be enriched. This enrichment would come at the expense of Hunter U.S., which would have earned the profit on the construction of the 11 gearboxes but for the fraud of Hunter Canada. Syncrude's actions in establishing the trust fund were interpreted by the appeal court as evidence of an acknowledgement by Syncrude that Hunter U.S. was entitled to the fund. The court was of the view that there was a sufficient causal nexus between the enrichment and the deprivation in the fact that Hunter Canada had performed all its contractual obligations with the exception of its service and warranty obligations. By offering to assume the warranty obligations of the Hunter Canada contract, Hunter U.S. satisfied the necessary causal connection. Finally, the Court of Appeal could find no juristic reason to justify Syncrude's enrichment. In the result, the court allowed the appeal of Hunter U.S. and held that Hunter U.S. was entitled to the whole of the trust fund and the income therefrom, except that Syncrude was entitled to deduct the sum of $200,000, being the agreed repair costs for which Hunter U.S. was responsible. It was held also that Syncrude be entitled to the income on the sum of $200,000 from the date of trial.

81 With respect, I am unable to agree with the view of the Court of Appeal and the view of my colleague, Wilson J., that the moneys in the trust fund established by Syncrude should be awarded to Hunter U.S. I can conceive of no basis in law or in equity for awarding the trust fund to Hunter U.S. Hunter U.S. is not entitled to those moneys under the terms of the trust agreement. Hunter U.S. has not satisfied any of the three criteria mentioned in *Pettkus v. Becker*, supra. In my view, there was no unjust enrichment and therefore no possibility of a constructive trust arising in this case. I would therefore allow the cross-appeal and declare that Syncrude is entitled to the principal of the trust fund and the interest accrued thereon.

82 If a restitutionary remedy is not available, Hunter U.S. is left trying to make a claim under a document the express terms of which deny recovery by Hunter U.S. Hunter U.S. provided nothing whatsoever to Syncrude in connection with the 11 gearboxes. Nor did Hunter Canada. All the work was done by Aco. The drawings were supplied by Syncrude. Counsel for Hunter U.S. lays emphasis on the fact that Hunter U.S. provided the design drawings to Aco under a pledge of confidentiality. That may be true but it overlooks the provision in the original contract between Syncrude and Hunter U.S. which required Hunter U.S. to provide Syncrude with such drawings, free of any such pledge. No restriction was placed on the use of these drawings by Syncrude. The design drawings were already in Syncrude's possession in 1977 and were provided to Aco by Syncrude. Hunter U.S. does not allege any breach of copyright on the part of anyone. Anderson J.A. refers to drawings "stolen from Hunter". No drawings were stolen by Syncrude.

83 The constructive trust has existed for over 200 years as an equitable remedy for certain forms of unjust enrichment. In its earliest form, the constructive trust was used to provide a remedy to claimants alleging that others had made profits at their expense. Where the claimant could show the existence of a fiduciary relationship between the claimant and the person taking advantage of the claimant, the courts were receptive: see Waters, The Law of Trusts in Canada, 2nd ed. (1984), at pp. 378-82. Equity would not countenance the abuse of the trust and confidence inherent in a fiduciary relationship and imposed trust obligations on those who profited from abusing their position of loyalty. The doctrine was gradually extended to apply to situations where other persons who were not in a fiduciary relationship with the claimant acted in concert with the fiduciary or knew of the fiduciary obligations. Until the decision of this court in *Pettkus v. Becker*, the constructive trust was viewed largely in terms of the law of trusts, hence the need for the existence of a fiduciary relationship. In *Pettkus v. Becker*, the court moved to an approach more in line with restitutionary principles by explicitly recognizing constructive trust as one of the remedies for unjust enrichment. In finding unjust enrichment the court, as I have said, invoked three criteria, namely, (1) an enrichment, (2) a corresponding deprivation, and (3) absence of any juristic reason for the enrichment. The court then found that in the circumstances of the case a constructive trust was the appropriate remedy to redress the unjust enrichment.

84 In determining whether a restitutionary remedy may be available in this case, an understanding of the legal positions of the three parties, Hunter U.S., Hunter Canada and Syncrude is of paramount importance. In my view, an analysis of the facts and of legal positions of all three parties reveals why a restitutionary remedy is not available to Hunter U.S.

85 I note that this appeal presents an unusually complex fact situation. Three parties are involved, rather than the two one usually finds when a constructive trust is advanced. Of the three parties, there is only one wrongdoer. Two of the parties, Syncrude and Hunter U.S., are completely innocent actors. As between the two innocent parties, only one will be entitled to the money in dispute. In my view, the complexities can best be minimized by examining separately the legal relationship between the wrongdoer and each of the innocent parties. Once the legal positions of Hunter U.S. and Syncrude are determined vis-à-vis Hunter Canada, the relationship between Hunter U.S. and Syncrude can be meaningfully examined.

86 There is no doubt that as between Hunter U.S., a company defrauded by disloyal employees, and Hunter Canada, Hunter U.S. would have been able to claim any profits made by Hunter Canada under the traditional doctrine of constructive trust. Hunter Canada was founded by trusted employees of Hunter U.S., persons who clearly stood in a fiduciary relationship to Hunter U.S. Equity will not permit a fiduciary to profit at the expense of its principal. The *Pettkus v. Becker* test for unjust enrichment would also be satisfied. Hunter Canada would be enriched to the amount of

the profit it would have received under its contract with Syncrude. The enrichment would be at the expense of Hunter U.S. There would be no juristic reason to justify the enrichment. As between Hunter U.S. and Hunter Canada, Hunter U.S. clearly has the better claim to money accruing to Hunter Canada.

87 An entirely different situation exists between Hunter Canada and Syncrude. The relations between Hunter Canada and Syncrude are regulated by contract. Syncrude can only be said to owe money to Hunter Canada on the basis of the agreement for gearboxes negotiated in 1977. Syncrude was induced to enter into that contract on the strength of Hunter Canada's fraudulent misrepresentations. It is a basic principle of contract law that where a party had entered into a contract, having been misled by a fraudulent misrepresentation, the contract is voidable at the instance of the innocent party: see Waddams, The Law of Contracts, at p. 308. Once Syncrude discovered Hunter Canada's deception, it was entitled to elect to continue with the contract or to treat the contract as at an end. Syncrude could not be compelled to continue with a contract it had been led to assume on fraudulent premises. As between Syncrude and Hunter Canada, Syncrude has a stronger claim to the money payable under the contract by virtue of its ability to elect to end the contract and retain the money it would have expended.

88 What, then, is the situation between Hunter U.S. and Syncrude? In my view, Syncrude is entitled to retain the money it would have paid under the Hunter Canada contract. The only connection between Hunter U.S. and Syncrude is Hunter Canada. Hunter U.S.'s claim to the entire trust fund arises only as a result of Hunter Canada's actions. As against Syncrude, Hunter U.S. has no higher claim than does Hunter Canada. While the actions of Hunter Canada are, on the one hand, essential to found Hunter U.S.'s claim of unjust enrichment, the need to rely on the conduct of Hunter Canada is fatal to this claim.

89 Hunter Canada's entitlement vis-à-vis Syncrude arose purely as a result of contractual obligation. Under ordinary principles of contract law, Syncrude could not be compelled to remain a party to the Hunter Canada contract. Even before the fraud of Hunter Canada was brought to light, it was open to Syncrude to breach the contract with Hunter Canada and to face an action for damages. In light of Hunter Canada's fraudulent misrepresentation to Syncrude, Syncrude was entitled to rescind the contract on the basis of fraud. Syncrude's actions in January through March 1978 essentially amounted to exercising its option to rescind. Rather than involve itself in the competing claims of Hunter Canada and Hunter U.S., Syncrude chose to extricate itself from the Hunter Canada contract as it was properly entitled to do. Syncrude's primary concern was the timely production of gearboxes. Syncrude sought to terminate its contract with Hunter Canada and requested Hunter Canada's approval of this course of action. Hunter Canada agreed to renounce its rights under the contract subject to the creation of a trust fund. Long before the legal resolution of the dispute between Hunter U.S. and Hunter Canada, the contract between Hunter Canada and Syncrude had come to an end as had any entitlement of Hunter Canada under the contract.

90 The result of Syncrude's decision to terminate the Hunter Canada contract and Hunter Canada's acceptance of the termination is that Hunter Canada is no longer entitled to any payment under the contract. In my view, this precludes any claim by Hunter U.S. as I have indicated. The claim of Hunter U.S. is predicated upon Hunter Canada's contractual entitlement. If Hunter Canada has no entitlement, Hunter U.S. has no entitlement. Hunter U.S. can be in no better position vis-à-vis Syncrude than that Hunter Canada occupies vis-à-vis Syncrude. Finding unjust enrichment in favour of Hunter U.S. on moneys held by Syncrude would be to found an entitlement deriving from a contractual entitlement of Hunter Canada that is no longer in existence.

91 Clause 8 of the trust agreement expressly provided that the trustee should refrain from making any payment out of the said trust fund and trust income "until the holder of the valid and lawful interest in the trust fund had undertaken, by agreement with Syncrude, to assume warranty and service obligations with respect to the work under the said Agreement, as provided expressly or impliedly by the provisions of the purchase orders identified in Schedule 'A' thereto, and until the trustee is notified by Syncrude of such agreement".

92 Hunter U.S. at no time gave any such undertaking. Hunter U.S. refused to become a party to the trust agreement. In its pleading in the present proceedings it claimed all the moneys in the trust fund but denied any obligation to honour

any warranty or service obligations as a condition of payment. In the Court of Appeal judgment the following passage appears at p. 385:

> I agree with counsel for Syncrude that Hunter would not be entitled to any profit if Hunter had refused to assume the obligations of Hunter Canada under the 1977 agreement. A court of equity would not assist Hunter in such a case. Moreover, there would not be a true "corresponding deprivation" or "causal connection".
>
> In the circumstances, it is not, however, open to Syncrude to contend that Hunter did not assume the service and warranty obligations contained in the 1977 agreement. Hunter offered to ratify or adopt the 1977 agreement made between Hunter Canada and Syncrude. Hunter offered to contract directly with Syncrude and to assume the service and warranty obligations contained in the 1977 agreement. Syncrude, prior to the discovery of the fraud, believed that Hunter Canada was the subsidiary of Hunter and, therefore, the offer made by Hunter to deal with Syncrude directly was exactly the contract Syncrude wanted in the first place. Syncrude, however, for reasons of its own and solely for its own benefit, refused to enter into any agreement with Hunter. Instead, it contracted with Aco, using Hunter's designs, and unilaterally attempted to impose onerous and additional obligations on Hunter.

93 Counsel for Syncrude strongly contests the finding that Hunter U.S. offered to assume the obligations of Hunter Canada. The evidence on this point is far from satisfactory. Hunter U.S. advanced no evidence on the point at trial other than a brief passage from an examination for discovery, which reads:

> Q. And there is this allegation: "At the time the plaintiff entered into the 1978 agreement, this defendant offered to assume all warranty and service obligations provided the plaintiff" that's Syncrude, "entered into contracts directly with this defendant", that's Hunter Engineering, and that is true as well, isn't it?
>
> A. Yes.

94 This is the best evidence Hunter U.S. can produce. There is no letter or other document evidencing such offer. No one testified, on behalf of Hunter U.S., in affirmation of the offer. Be that as it may, Hunter U.S. declined to be a party to the trust agreement or to the 1978 agreement and has since consistently denied any warranty obligations. Equally, if such an offer was made, I cannot understand why, in light of the circumstances prevailing at the time, Syncrude was under any obligation to accept such an offer.

95 At the time Syncrude rescinded the Hunter Canada contract, Syncrude was free to procure the gearboxes any way it pleased. If a company unrelated to either Hunter Canada or Hunter U.S. offered to supply the gearboxes on more advantageous terms, Hunter U.S. could not have prevented Syncrude from contracting with that other company. Viewing Hunter U.S.'s offer as a sufficient connection between Syncrude and Hunter U.S. to found a restitutionary remedy in Hunter U.S.'s favour is tantamount to compelling it to contract with Hunter U.S.

96 It is no answer to say that at some time in the negotiations Hunter U.S. agreed to assume the service and warranty obligations contained in the 1977 agreement. Opinions and attitudes frequently change in negotiations and it is clear that Hunter U.S. changed. It refused to sign the 1977 agreement or the trust agreement when the time came. Even after the trial judge awarded Hunter U.S. the trust fund under the terms of the trust agreement on the condition that Hunter U.S. accept the warranty provision within a certain period of time, Hunter U.S. did not assume the Hunter Canada warranty. The moneys paid into the trust fund can only be viewed as having been originally owed to Hunter Canada to pay for services that Syncrude had purchased from it. If Hunter U.S. is to receive those moneys, then it should also be found that it would have been liable insofar as any of those services were not provided. Yet it is difficult to see what Hunter U.S. might be liable for. An important "service" which Syncrude purchased from Hunter Canada was the extended warranty which Hunter Canada offered. Hunter U.S. did not take up their warranty and, therefore, could not have been held liable under it. Thus, it would be unfair to award it moneys intended to compensate the party which had agreed to assume the risks inherent in the warranty. In my view, it is no longer open to Hunter U.S. to claim under the express trust agreement.

97 In imposing a constructive trust in the circumstances of this case, the Court of Appeal carried the decision in the *Pettkus* case beyond the breaking point. Apart perhaps from an element of sympathy which one might have because of the attempt by its dishonest employees to cheat Hunter U.S., I can find nothing which would entitle Hunter U.S. to the funds set aside by Syncrude pursuant to an agreement with Hunter Canada in an attempt to extricate itself from an extremely difficult and potentially costly situation created by Hunter's employees or former employees. In my view, if Hunter U.S.'s claim prevailed, (i) Hunter U.S. would be enriched, (ii) with a corresponding deprivation of Syncrude, (iii) and for no juristic reason that I am able to detect.

98 The impact of a finding of constructive trust, as per the Court of Appeal, as compared with a finding of entitlement under the terms of the express trust is not minimal. Clause 9 of the trust agreement provides that reasonable legal expenses incurred by the trustee in the performance of his duties and remuneration to the trustee are to be paid from the trust funds. If all of the trust funds are payable to Hunter U.S. under a constructive trust, to whom does the trustee look for payment of his remuneration and the legal expenses he has incurred?

99 I disagree with the interpretation the Court of Appeal and Wilson J. have placed on Syncrude's decision to establish the trust fund. I do not see the creation of the trust as an admission on the part of Syncrude that either Hunter U.S. or Hunter Canada was entitled to the profit under the Hunter Canada contract. Upon suspecting fraud, Syncrude was entitled to rescind the Hunter Canada contract. Until Syncrude was completely convinced that Hunter Canada was fraudulent, rescission entailed a certain amount of risk. Had the litigation between Hunter U.S. and Hunter Can ada been resolved in Hunter Canada's favour, Syncrude would have been vulnerable to an action for breach of contract by Hunter Canada. It could protect itself against a lawsuit by requesting Hunter Canada's approval of its decision to consider the contract at an end. In my view, it was not strictly necessary for Syncrude to secure Hunter Canada's acceptance of its termination of the contract. Nor was it necessary for Syncrude to establish a trust fund. Syncrude's decision to create a trust fund, motivated no doubt by an abundance of caution, should not make it worse off than it would have been had it simply rescinded the contract. There was no onus on Syncrude to secure the approval of Hunter U.S. who was not even a party to the contract, to the terms of the trust fund.

100 The Court of Appeal said at p. 384:

> The trust balance represents the profit Hunter would have earned by designing the 11 gearboxes but for the fraud of Hunter Canada. The judgment of Meredith J. establishes that these funds are rightfully the property of Hunter. So much is acknowledged by Syncrude in the trust agreement. It follows that the trust income is also the property of Hunter.

101 I do not understand how it can be said that the trust balance represented the profit Hunter U.S. would have earned by designing the 11 gearboxes. Hunter U.S. earned its profit on the gearbox design when Syncrude paid Hunter U.S. for 32 mining gearboxes and for the design under the 1975 contract. The judgment of Meredith J. said nothing with respect to Syncrude's entitlement to the funds held in trust as Syncrude was not a party to that action.

102 Wilson J. makes the point that Syncrude was ready to pay the principal contractor's portion to Hunter U.S. and that Syncrude cannot now argue that it had no need of Hunter U.S. Reliance is placed on cl. 7 of the trust agreement. At the time of the agreement Syncrude appears to have been prepared to pay the principal contractor's portion to Hunter U.S., but upon terms to which Hunter U.S. did not agree. Syncrude had no need of Hunter U.S. The facts bear that out. Syncrude's act of establishing a trust fund was not an admission that the trust moneys belonged to either Hunter U.S. or Hunter Canada, but, at most, an indication that it was willing to pay the contract price if it received its negotiated warranties. Even if Hunter U.S. did make an offer to assume the warranties prior to the litigation between Hunter U.S. and Hunter Canada, Syncrude was not then, as I have indicated, in a position to have accepted.

103 I am therefore of the view that Hunter U.S.'s claim to the moneys in the trust fund under constructive trust fails. I am also of the view that Hunter U.S. is not entitled to claim under the express terms of the trust agreement. To qualify

under the trust agreement, Hunter U.S. would have had to agree to the terms of the trust agreement. It did not do so. The most important of these terms was the agreement to assume the Hunter Canada warranty provisions.

104 Clause 10 of the trust agreement made provision for the precise situation which developed. It provides:

> In the event that Syncrude and the holder of the valid and lawful interest in the trust fund are unable to agree with respect to the warranty and service of Work in Schedule "A" of the said Agreement, *the trustee shall pay the remainder of the trust fund*, as determined by Clause 7 and Clause 8 of this Agreement, *to Syncrude*. [emphasis added]

105 The trial judge, at p. 82, gave Hunter U.S. until October 1984, later extended, to assume the warranty and service obligations:

> That valid and lawful interest [the interest of Hunter U.S. in the trust fund] does not crystallize into an entitlement or right to be paid until the condition precedent of assumption of the Hunter Canada warranty and service obligations by agreement with Syncrude has been met. The trust income accruing prior to the date upon which the condition precedent is met belongs to Syncrude under cl. 11 of the trust agreement.

106 In my view, with respect, the judge erred in allowing Hunter U.S. to become entitled to the trust moneys by assuming the warranty obligation after judgment without incurring liability for warranty claims prior to its assumption of the warranties. The purpose of the trust fund was to ensure someone would promptly assume the warranties. Once Hunter U.S. elected not to do this, giving it another chance potentially requires the trustee to hold the fund in perpetuity. The trial judge erred by arbitrarily imposing a later date than that which would have entitled Hunter U.S. to the trust fund.

107 I am of the view that the judgment of the Court of Appeal of British Columbia be set aside. The cross-appeal of Syncrude should be allowed with costs here and below. The appeal of Hunter U.S. should fail and must be dismissed with costs. The appeal from that part of the judgment of the Court of Appeal which imposed liability on Allis-Chalmers Canada Limited should be allowed with costs here and below, payable by Syncrude.

***McIntyre J.*:**

108 I agree with Wilson J. that the appeal of "Hunter U.S." against the finding of liability for a design fault should be dismissed and I agree, as well, that the appeal of "Allis-Chalmers" should succeed. I agree with Wilson J. that any breach of the contract by Allis-Chalmers was not fundamental and, in any event, even if the breach were properly characterized as fundamental, the liability of Allis-Chalmers would be excluded by the terms of the contractual warranty. In my view, it is therefore unnecessary to deal further with the concept of fundamental breach in this case.

109 As to the issue concerning the trust fund, I agree with the Chief Justice that the cross-appeal, claiming ownership of the trust fund, by "Syncrude", should be allowed with costs here and below, and I agree with his reasons for reaching this conclusion. In the result, then, I would dispose of the appeal as would the Chief Justice.

***Wilson J.* (dissenting in cross-appeal) (*L'Heureux-Dubé J.* concurring):**

110 This appeal and cross-appeal raise a variety of issues relating to the interpretation of engineering contracts. They also require the court to consider the effect of exclusionary clauses in the context of implied statutory warranties and in the context of fundamental breach. The viability of the doctrine of fundamental breach is itself in issue as is also the applicability of the law of constructive trust to the facts of this case.

1. The Facts

111 The disputes between these parties arise out of three contracts for the supply of gearboxes for the Alberta tar sands industry. In the first contract, made on 29th January 1975, Syncrude Canada Ltd. ("Syncrude"), through its agent Canadian Bechtel, ordered 32 "mining gearboxes" from the Hunter Engineering Company Inc. ("Hunter U.S."). These

gearboxes were intended to drive conveyor belts which move sand to Syncrude's extraction plant at Fort McMurray where the oil is separated out. The responsibility of each of the contracting parties for the various design features of the gearboxes is one of the matters in dispute before the court and I will deal below with these aspects of the contract. The 32 mining gearboxes were manufactured by a subcontractor (ACO Sales and Engineering), delivered to Syncrude between January 1977 and February 1978, and entered service on 4th July 1978.

112 The second contract was made on 29th July 1975 between Syncrude and Stephens-Adamson Ltd., a division of Allis-Chalmers Canada Ltd. ("Allis-Chalmers"). It was for the supply of a $4.1 million extraction conveyor system which included four "extraction gearboxes" to drive the machinery which separates the oil from the sand. Although supplied un der the contract with Allis-Chalmers, they were built according to the same design as the mining gearboxes supplied by Hunter U.S. and like them were fabricated by the subcontractor ACO. The extraction gearboxes entered service on 24th November 1977.

113 The third contract was made between Syncrude and ACO on 1st March 1978. It arose out of some unusual circumstances. Between August and December 1977 Syncrude issued purchase orders to Hunter Machinery Canada Ltd. ("Hunter Canada") for an additional 11 mining gearboxes built to the same design as the 32 purchased from Hunter U.S. Hunter Canada was a Canadian-incorporated company established by employees of Hunter U.S. without the latter's knowledge. It held itself out to Syncrude as the Canadian arm of Hunter U.S. and not until January 1978 did Hunter U.S. discover the deception. It initiated a "passing-off" action against Hunter Canada in the British Columbia courts, notified Syncrude and offered to assume the Hunter Canada contract. Syncrude, however, opted not to prejudge the result of the litigation by agreeing to let Hunter U.S. step into the contractual shoes of Hunter Canada and, instead of accepting this offer, it contracted directly with the subcontractor ACO for supply of the 11 gearboxes which were the subject of the Hunter Canada contract at an identical price to that which ACO would have received from Hunter Canada. These 11 gearboxes were delivered and progressively put into service between May and December 1978.

114 Then, in March 1978 Syncrude unilaterally established a trust fund into which it paid the money due under the Hunter Canada contracts. Hunter Canada waived all rights under these contracts but Hunter U.S. refused to become a party to Syncrude's trust agreement. That agreement provided, inter alia, that the trustee would pay to ACO its price for the gearboxes when they were completed. The rest of the money in the fund was to be dealt with as follows:

> 7. The trustee shall hold the remainder of the trust funds and trust income for payment pending determination by agreement between Hunter Canada and Hunter Engineering, or by a decision of a Court of competent jurisdiction in Canada as to the identity of the holder of a valid and lawful interest in the remainder of trust funds as between Hunter Engineering and Hunter Canada, or upon determination of certain issues in Canada, currently the subject of legal proceedings between Hunter Engineering and Hunter Canada by settlement agreement or by a decision of a Court of competent jurisdiction in Canada.

Clause 8 of the fund made any such payment contingent upon an assumption by Hunter U.S. or Hunter Canada of the warranty and service obligations contained in Syncrude's 1977 agreements with the latter. Clause 9 provided for the payment of the trustee's expenses out of the fund. Clause 10 stated that if the winner of the Hunter U.S.-Hunter Canada litigation did not assume the service and warranty obligations mentioned in cl. 8, the money would go to Syncrude. Clause 11 specified that any money remaining after payment to ACO and satisfaction of the requirements of cls. 7-9, including any trust income, would be paid to Syncrude.

115 In December 1978 Meredith J. of the British Columbia Supreme Court gave judgment to Hunter U.S. (*Hunter Engr. Co. v. Hunter Machinery Can.*, Vancouver No. C780211, 28th December 1978 (unreported)). The judgment included a declaration that as between Hunter U.S. and Hunter Canada the former was entitled to the money referred to in cl. 7 of the trust agreement. The trust fund remained in place, however, because the parties could not agree on warranty and service terms. Hunter U.S. wanted the same terms as in its other contract with Syncrude. The latter insisted on the more extensive guarantees contained in its contract with Hunter Canada and specifically mentioned in the trust agreement. I pause here to note that this dispute arose before the defects in the gearboxes discussed below were discovered.

116 In September 1979 defects were discovered in the extraction gearboxes. These gearboxes were made up of gears, shafts and bearings housed within a steel casing. Each box contained a number of smaller gears and one large one, the bull gear, some 6 1/2 feet in diameter. The bull gear attaches to the drive shaft by two steel plates, one on each side of the rim. It was found that the welds joining these side plates and the rim had cracked under the strain because the welding was not continuous all the way around the rim. The extraction gearboxes were progressively taken out of service and repaired, primarily by putting in a continuous weld. This apparently solved the problem. On examination in October 1979 the same problem was discovered with the smaller (5 1/2 feet in diameter) bull gears in the mining gearboxes. All 47 gearboxes were progressively taken out of service and repaired. Total repair expenses, not including interest, amounted to $750,000 for the mining gearboxes and $400,000 for the extraction gearboxes. Neither Hunter U.S. nor Allis-Chalmers considered themselves responsible for these repair expenses on the grounds that their contractual warranties had expired. Syncrude commenced proceedings in the British Columbia courts.

2. The Judgments Below

(a) British Columbia Supreme Court

117 In a judgment delivered in July 1984 and reported at 27 B.L.R. 59, the trial judge, Gibbs J., dealt first with the question of design responsibility. This was a threshold issue since Hunter U.S. had argued before him that Canadian Bechtel, Syncrude's agent, provided the design on the basis of which Hunter U.S. built the gearboxes. The trial judge found, however, that while Bechtel had provided specifications which gave "detailed operating criteria", these specifications did "not extend to design details". Design was Hunter U.S.'s responsibility and the trial judge's review of the evidence convinced him that the failure of the gearboxes was due to design default.

118 Having established the prima facie responsibility of both Hunter U.S. and Allis-Chalmers, Gibbs J. considered the effect of the warranty clauses in the sales agreements. Both contained the following clause:

> 8. WARRANTIES — GUARANTEES: Seller warrants that the goods shall be free from defects in design, material, workmanship, and title, and shall conform in all respects to the terms of this purchase order, and shall be of the best quality, if no quality is specified. If it appears within one year from the date of placing the equipment into service for the purpose for which it was purchased, that the equipment, or any part thereof, does not conform to these warranties and Buyer so notifies Seller within a reasonable time after its discovery, Seller shall thereupon promptly correct such nonconformity at its sole expense. The conditions of any subsequent tests shall be mutually agreed upon and Seller shall be notified of and may be represented at all tests that may be made. Except as otherwise provided in this purchase order, Seller's liability hereunder shall extend to all damages proximately caused by the breach of any of the foregoing warranties or guarantees, but such liability shall in no event include loss of profit or loss of use.

Both warranties were modified by the purchase orders so that they expired either 24 months after delivery or 12 months after the gearboxes entered service, whichever occurred first. Gibbs J. found that the time limit in the warranties excused both companies from liability under them.

119 This did not, however, dispose of the issue of liability because the general conditions of each agreement also provided that:

> 13. APPLICABLE LAW — DEFINITIONS: The definition of terms used, interpretation of this agreement and the rights of all parties hereunder shall be construed under and governed by the Laws of the Province of Ontario.

The Ontario Sale of Goods Act, R.S.O. 1970, c. 421, s. 15, provides a statutory warranty of fitness:

> 15. Subject to this Act and any statute in that behalf, there is no implied warranty or condition as to the quality or fitness for any particular purpose of goods supplied under a contract of sale, except as follows:

> 1. Where the buyer, expressly or by implication, makes known to the seller the particular purpose for which the goods are required so as to show that the buyer relies on the seller's skill or judgment, and the goods are of a description that it is in the course of the seller's business to supply (whether he is the manufacturer or not), there is an implied condition that the goods will be reasonably fit for such purpose, but in the case of a contract for the sale of a specified article under its patent or other trade name there is no implied condition as to its fitness for any particular purpose.
>
> 4. An express warranty or condition does not negative a warranty or condition implied by this Act unless inconsistent therewith.

120 Gibbs J. found that this statutory warranty was not excluded by the contractual warranty. It was therefore applicable to the Hunter U.S. contracts. In deciding whether Hunter U.S. had breached the statutory warranty, he applied the following test from Fridman, Sale of Goods in Canada, 2nd ed. (1979), at pp. 203-204:

> The implied condition set out in section 15(1) applies, except where the proviso to that subsection operates, "where the goods are of a description which it is in the course of the seller's business to supply (whether he be the manufacturer or not)" and "where the buyer, expressly or by implication, makes known to the seller the particular purpose for which the goods are required, so as to show that the buyer relies on the seller's skill or judgment." Three factors are therefore relevant: (1) the course of the seller's business: (ii) knowledge on the part of the seller of the purpose of the goods: (iii) reliance on the seller's skill or judgment. Only if a contract of sale satisfies these requirements will it be possible to imply into the condition of fitness of the goods that is contained in this subsection.

Gibbs J. found that all three aspects of the test were met. The gearboxes "were goods which it was in the course of the business of Hunter U.S. to supply" and Hunter U.S. "knew the purpose for which the gearboxes were required". The third aspect of the test [p. 72]:

> ... is satisfied by the express provision in the Canadian Bechtel specifications, incorporated by reference into the Hunter U.S. purchase order that: "Correct and adequate design is the Seller's sole responsibility". I understand those words to convey, in plain and simple language, that Syncrude, through Canadian Bechtel, was relying upon the skill and judgment of Hunter U.S. in matters of gearbox design. It is evident from the [evidence] that they held themselves out as being possessed of the requisite skill and judgment.

121 This finding applied only to the contracts between Syncrude and Hunter U.S. The Allis-Chalmers purchase order, in addition to modifying the sales agreement in the same way as that of Hunter U.S., also contained this more extensive change:

> The final sentence of Paragraph 8 is hereby deleted. In its place shall be, "The Provisions of this paragraph represent the only warranty of the Seller and no other warranty or conditions, statutory or otherwise shall be implied."

Gibbs J. considered this sufficient to exclude the statutory warranty in the Allis-Chalmers contract.

122 The trial judge then turned his attention to Syncrude's claim that Allis-Chalmers had nevertheless committed a fundamental breach of contract so as to negate the exclusion clause. He rejected the argument for two reasons. First, he held at p. 77 that Syncrude had fully and freely accepted the exclusion clause:

> With respect to the clause excluding statutory or other warranties or conditions, it is significant to me that liability was not completely excluded. Liability still existed under warranty cl. 8 of the general conditions, limited only in time to the twelve or twenty-four month period. Warranty cl. 8 was put forward by Syncrude. Presumably it provided the protection Syncrude wanted ... Syncrude freely accepted the time limitations; there is no evidence that they were under any disadvantage or disability in the negotiating of them. There is no reason why they should not be held to their bargain, including that part which effectively excludes the implied condition of s. 15(1) of the Ontario Sale of Goods Act.

Second, he did not consider that the problems with the gearboxes amounted to a fundamental breach (pp. 77-78):

> As to the nature of the defect, in my opinion it was not so fundamental that it went to the root of the contract. The contract between the parties was still a contract for gearboxes. Gearboxes were supplied. They were capable of performing their function and did perform it for in excess of a year which, given the agreed time limitations, was the "cost free to Syncrude" period contemplated by the parties. It was conceded that the gearboxes were not fit for the service. However, the unfitness, or defect, was repairable and was repaired at a cost significantly less than the original purchase price ... On my appreciation of the evidence Syncrude got what it bargained for from Stephens-Adamson. It has not convinced me that there was fundamental breach.

123 The final issue dealt with at trial concerned the trust fund unilaterally set up by Syncrude pending the outcome of the Hunter U.S./Hunter Canada litigation. When Hunter U.S. initiated its passing-off action it offered to assume the entire Hunter Canada contract with Syncrude, including this warranty:

> SELLER expressly warrants that the goods covered by this order are of merchantable quality, and satisfactory and safe for the use of the PURCHASER. Acceptance of the order shall constitute an agreement upon SELLER'S part to indemnify and hold the PURCHASER harmless from liability, loss, damage and expense, incurred or sustained by PURCHASER by reason of the failure of the goods to conform to such warranties.

As noted above, Syncrude opted instead to set up the trust fund, including the provision that acceptance of the Hunter Canada warranty was a precondition to receiving payment from it. After Hunter U.S. was successful in its action against Hunter Canada it was no longer prepared to assume the full warranty, preferring to substitute the same guarantees as were contained in its other contract with Syncrude, and claimed ownership of the fund on that basis.

124 By the time this matter came to trial the trust fund held $420,000. The cost of repairs to the 11 mining gearboxes, for which Hunter U.S. had been found liable, was $200,000 inclusive of prejudgment interest. Gibbs J. held that Syncrude should receive the income from the original fund and that Hunter U.S. was entitled to the principal of $242,229 but only if it met the conditions, particularly the warranty obligation, of the Hunter Canada contract. Hunter U.S. was given approximately two months to do so, failing which Syncrude would be entitled to keep all the money. Gibbs J. rejected an argument by Hunter U.S. that it was entitled to the entire fund "under the doctrines of constructive trust and unjust enrichment". He said at p. 81:

> In my opinion, the entitlement to the trust moneys is to be determined solely in accordance with the terms of the trust agreement ... There was no fiduciary relationship between Syncrude and Hunter U.S.; there had not been a payment of money or delivery of property by Hunter U.S. to Syncrude under circumstances where it would be against conscience for Syncrude to retain it; Hunter U.S. was not a party with Syncrude to any agreement which gave Hunter U.S. a claim on Syncrude's funds. Hunter U.S. had, and established, a claim against Hunter Canada. If Syncrude had paid the purchase price to Hunter Canada, on the authorities, Hunter U.S. could have recovered the profit element from Hunter Canada because of the fiduciary duty owed to Hunter U.S. by those of its employees who were the owners of Hunter Canada. In my opinion however, in the absence of the trust agreement, Hunter U.S. would have no claim against Syncrude. It had not contracted with Syncrude, nor had it provided any of those things for which profit stands as compensation, such as risk capital, skilled and knowledgeable staff, supervision, overhead, and like matters. None of its plant or personnel had been used.

The final judgment in favour of Syncrude was for $750,000 plus prejudgment interest plus whatever sum it eventually kept from the trust fund.

(b) British Columbia Court of Appeal

125 Syncrude appealed the finding of no fundamental breach by Allis-Chalmers and Hunter U.S. cross-appealed the other findings by Gibbs J. The Court of Appeal (Carrothers, Aikins and Anderson JJ.A.), in a judgment reported

at 68 B.C.L.R. 367, rejected Hunter U.S.'s appeal on its liability under the statutory warranty primarily by adopting the reasoning of the trial judge. Anderson J.A., for the court, in dealing with Hunter U.S.'s argument that it was not responsible for the design faults, added this comment at p. 377:

> ... the reasons for judgment of the learned trial judge were based on a comprehensive consideration of the evidence. He heard all the witnesses and examined all of the documentary evidence and it is difficult, if not impossible, for this court to substitute its judgment for that of the trial judge by fragmentary reference to the evidence and the contract documents, as counsel for Hunter would have us do. Palpable and overriding error cannot be demonstrated in that way.

126 The Court of Appeal did, however, allow Hunter U.S.'s appeal on the ownership of the income from the trust fund. Anderson J.A. said at p. 382:

> In my opinion, this issue falls to be determined by reference to the judgment of the Supreme Court of Canada in *Pettkus v. Becker* ... In that case, Dickson J. (as he then was), speaking for the majority, set forth the criteria necessary to establish a successful claim for unjust enrichment as being:
>
> (1) An enrichment of the defendant;
>
> (2) A corresponding deprivation of the plaintiff;
>
> (3) The absence of a juristic reason for the enrichment.

He then held that, were Syncrude to retain the trust income, it would be unjustly enriched and Hunter U.S. correspondingly deprived of income from profit rightfully theirs but for the fraud of Hunter Canada. No juristic reasons justified the enrichment of Syncrude. Provided Hunter U.S. adopted the warranty obligations in the Hunter Canada contract, it was entitled to the fund after trustee's expenses minus the sum required to repair the 11 gearboxes, i.e., $200,000.

127 The Court of Appeal also allowed Syncrude's appeal against Allis-Chalmers on the question of fundamental breach. Anderson J.A. found that the warranty exclusion clause, although broad, was not broad enough " 'to destroy the foundation of the contract and its business efficacy by eliminating the ... essential undertaking' of Allis-Chalmers to provide gearboxes capable of meeting the requirements of the extraction process" (p. 392). He then went on to note:

> There is, however, another compelling reason for holding that the warranty clause was not intended to exclude claims for "fundamental breach". The contract between Syncrude and Allis-Chalmers included a "Limitation of Liability" clause, reading as follows:
>
> > Paragraph 14 — Limitation of Liability
> >
> > Notwithstanding any other provision in this contract or any applicable statutory provisions neither the Seller nor the Buyer shall be liable to the other for special or consequential damages or damages for loss of use arising directly or indirectly from any breach of this contract, *fundamental* or otherwise or from any tortious act or omissions of their respective amployees [sic] or agents and in no event shall the liability of the Seller exceed the unit price of the defective product or of the product subject to late delivery.
>
> [The italics are mine.]
>
> It will be seen that this clause clearly stipulates that Allis-Chalmers shall not be liable "for special or consequential damages or damages for loss of use arising directly or indirectly from any breach of this contract, *fundamental* or otherwise". It follows that if claims for "fundamental breach" were excluded by the terms of the warranty clause, it would not have been necessary to make specific provision for the exclusion of liability in cases where the

"fundamental" breach resulted in a "loss of use" claim. In other words, when the parties intended to exclude liability for "fundamental breach", they said so in clear and express terms.

128 Having found that liability for fundamental breach was not excluded, Anderson J.A. held Allis-Chalmers liable on that ground. The cost of repairs was 86 per cent of the purchase price and the bull gear failed after less than two years' service when it should have lasted for ten. Accordingly, "Allis-Chalmers was in 'fundamental' breach because Syncrude was deprived of substantially the whole benefit of the contract" [p. 393].

129 The Court of Appeal's judgment thus gave Syncrude the $750,000 it had won at trial plus $400,000 for repairs to the extraction gearboxes. Interest on both these sums brought the total to $1.535 million.

3. The Issues Before This Court

130 Both Hunter U.S. and Allis-Chalmers appealed to this court and there is also a cross-appeal by Syncrude concerning the Court of Appeal's award of the trust fund to Hunter U.S. Four separate grounds of appeal were argued. I will deal with them in the following order:

131 (i) the liability of Hunter U.S. for the design faults which caused the gearboxes to fail;

132 (ii) the liability of Hunter U.S. under the statutory warranty in the Sale of Goods Act;

133 (iii) the liability of Allis-Chalmers under the doctrine of fundamental breach;

134 (iv) the ownership of the trust fund.

(i) Responsibility for design faults

135 In argument before this court Mr. Giles, counsel for Hunter U.S., devoted much of his time to this aspect of the appeal. He sought to persuade us that Hunter U.S. had merely designed the gears according to the specifications laid down by Canadian Bechtel, Syncrude's agent. Accordingly, if the specifications were inadequate for the task to be performed, the fault was that of Syncrude and not Hunter U.S. Hunter U.S. could only be to blame if its design failed to meet those specifications. Since Syncrude led no evidence to show that Hunter U.S.'s design failed to comply with Bechtel's specifications, the verdict of the trial judge was unreasonable.

136 As noted in my review of the judgments below, this argument was considered and rejected both by the trial judge and the British Columbia Court of Appeal. I do not believe that Mr. Giles' position finds any support in the terms of the contract between the parties. I would accordingly adopt the findings of the courts below on this issue. I will, however, add some observations of my own. In the purchase order of 29th January 1975 Hunter U.S.'s task is stated to be to "furnish all labour and material for the design, fabrication and delivery of the following equipment in accordance with specification 9776-3T-14 in your possession". The use of the word "design" in addition to "fabrication" indicates a creative role for Hunter U.S. going well beyond the mere construction of a gearbox from specifications prepared for Syncrude by Canadian Bechtel. The willingness of Hunter U.S. to take on such a role is further evidenced by its tender to Syncrude of 20th February 1974 which contains inter alia the following statements:

> This specification is for a geared drive assembly designed to power a belt conveyor.
>
> This drive group *has been designed for installation and operation in the remote areas and hostile environment normal to the mining industry*. The units are designed for a high degree of reliability based on design arts developed in similar installations ...
>
> This specification has been prepared to qualify HUNTER ENGINEERING COMPANY, INC., as a competent and experienced manufacturer of specialized gear drive equipment.

> Hunter drives are designed for specific applications, incorporating those features required to minimize operational and environmental hazards having an adverse effect on the performance of the unit. *Our market effort is directed towards those unique applications which challenge our designers' ingenuity. Hunter has the engineering, manufacturing and financial resources to supply the complete drive package designed to reliably power any defined processing function.* [emphasis added]

137 Perhaps more significantly, the specifications referred to in the purchase order are, in layman's language, specifications about what the gearboxes were required to do, not specifications of how they were to be built. Section 1.11 of those specifications states that "correct and adequate design is the seller's sole responsibility". Sections 4 and 5 provide information about site elevation, climatic conditions and expected hours of operation of the gears. Section 7 warns the seller of the need for materials able to withstand the extreme climate of the tar sands region. Other sections, particularly s. 10, lay out further details of what the gearboxes were required to do and make reference to how to achieve this. Some of these references are very general, for example, s. 10.1.1:

> 10.1.1 All components shall be of heavy duty design as required for the specified operating conditions.

Some of the references are more specific. For example, in 10.2.6, dealing with "Housings", it states:

> Housings shall be made from steel, stress relieved after welding in accordance with 8.2.2...
>
> Generous inspection openings with bolted and gasketed doors complete with lifting handles shall be provided in the housing cover, to allow for inspection of high speed, intermediate and low speed gearing without removal of major housing sections. In addition, the upper half of the housing shall be removable to allow for removal and replacement of gearing ...
>
> Housings shall be provided with oil level indicators at each point in the housing where oil level is critical to successful reducer performance.

138 I include these extracts merely to illustrate the kinds of general requirements — operating conditions, operating load and hours, desired features — that are put forward in the specifications. Nowhere is there any instruction to Hunter U.S. about what thickness of steel should be used for the gear housings or about how the assembly was to be put together. There may be aspects of this contract where the dividing line between the responsibilities of the parties is unclear but I do not think that this is one of them. I do not believe there is any need to delve further into the details of the contract and Syncrude's specifications. The extracts that I have summarized and quoted demonstrate the different roles played by the parties. Syncrude's specifications are a recitation of what the gearboxes should be able to achieve and general guidelines as to how this should be done. Hunter U.S. took on the task of deciding specific design details. The thickness of the steel plates and the way in which the gear housing was to be welded together were both within Hunter U.S.'s purview. It was these design decisions that proved to be wrong. Hunter U.S.'s appeal on this issue must accordingly fail.

(ii) The statutory warranty

139 Although Hunter U.S. was liable for the design fault that caused the gearboxes to fail, the failure was discovered after the contractual warranty period had expired. For Syncrude to succeed, therefore, it must find an alternative route to establishing Hunter U.S.'s liability. Two issues are of concern here. The first is whether either or both of the exclusionary clauses in the Hunter U.S. and Allis-Chalmers contracts are sufficient to preclude the application of the statutory warranty. If not, then a second issue arises as to whether the gearboxes were "reasonably fit" for their purpose.

140 I would answer these questions in the same way as Gibbs J. and the British Columbia Court of Appeal. Section 15(4) of the Sale of Goods Act provides that an express warranty "does not negative a warranty or condition implied by this Act unless inconsistent therewith". Hunter U.S. argues that it may invoke s. 15(4) because the specific limitation period in its express warranty serves to exclude any other warranty which would extend beyond that period. This argument

runs counter to two long-established and related principles in the law of contract, (1) that an exclusion clause should be strictly construed against the party seeking to invoke it, and (2) that clear and unambiguous language is required to oust an implied statutory warranty: see *Wallis, Son & Wells v. Pratt & Haynes*, [1911] A.C. 394 (H.L.); *R.W. Heron Paving Ltd. v. Dilworth Equip. Ltd.*, [1963] 1 O.R. 201, 36 D.L.R. (2d) 462 (H.C.); *Cork v. Greavette Boats Ltd.*, [1940] O.R. 352, [1940] 4 D.L.R. 202 (C.A.); Fridman, Sale of Goods in Canada, 3rd ed. (1986), p. 282. I would adopt the following statement of the law by Eberle J. of the Ontario Supreme Court in *Chabot v. Ford Motor Co. of Can.* (1982), 39 O.R. (2d) 162, 19 B.L.R. 147, 22 C.C.L.T. 185, 138 D.L.R. (3d) 417 at 430:

> ... although a vendor may exclude conditions implied by the *Sale of Goods Act*, he must use explicit language, in the absence of which the court will not be prepared to find that the conditions have been excluded.

141 In the present case there is clearly no explicit exclusion of the implied warranty contained in the Hunter U.S. contract. I find it equally clear that the revision to the Allis-Chalmers agreement did explicitly and unambiguously oust the statutory warranty by stating: "The Provisions of this paragraph represent the only warranty of the seller and *no other warranty* or conditions, *statutory or otherwise* shall be implied" (my emphasis). The explicit reference to the statutory warranty is crucial here and in my view serves to prevent the application of s. 15(1) of the Sale of Goods Act to the Allis-Chalmers contract.

142 This finding on the Hunter U.S. warranty requires a consideration of whether the gearboxes were, in the words of s. 15(1) of the Act, "reasonably fit" for the purpose for which they were supplied. I think this issue can be disposed of very shortly. It is abundantly clear that Syncrude informed Hunter U.S. of the purpose for which the gearboxes were required, that Syncrude relied on Hunter U.S.'s expertise, and that the gears were "goods ... which it is in the course of the seller's business to supply". It is equally clear that the gears were not reasonably fit for their purpose. The trial judge found as facts that:

143 (a) the gears would normally be expected to work for ten years before needing extensive overhauling;

144 (b) the gears needed to be replaced after only 15 months or so, despite never being put to more than 60 per cent of their intended workload;

145 (c) the cost of repairing the extraction gearboxes was $400,000 compared to the original price of $464,300;

146 Gibbs J.'s conclusion was that in such circumstances the gears could not be considered reasonably fit for their purpose. The Court of Appeal endorsed that finding and I would unequivocally affirm it also. The defects in design were crucial. The cracking was not something that would be expected to happen in the normal lifetime of the gearboxes. I would conclude therefore that Hunter U.S. is liable for the cost of repairs to the mining gearboxes.

(iii) Fundamental breach

147 Fundamental breach has been the subject of many judicial definitions. It has been described as "a breach going to the root of the contract" (*Suisse Atl. Soc. d'Armement Maritime S.A. v. N.V. Rotterdamsche Kolen Centrale*, [1967] 1 A.C. 361, [1966] 2 W.L.R. 944, [1966] 2 All E.R. 61 (H.L.), per Lord Reid at p. 399), and as one which results "in performance totally different from what the parties had in contemplation" (*R.G. McLean Ltd. v. Can. Vickers Ltd.*, [1971] 1 O.R. 207, 15 D.L.R. (3d) 15 (C.A.), per Arnup J.A. at p. 20). In *Canso Chem. Ltd. v. Can. Westinghouse Co.* (1974), 54 D.L.R. (3d) 517, 10 N.S.R. (2d) 306 (C.A.), MacKeigan C.J.N.S. gave nine different definitions from leading Canadian and United Kingdom cases. The definitional uncertainty that has pervaded this area of the law is further illustrated by Fridman, Law of Contract in Canada, 2nd ed. (1986), at p. 531, and the cases cited therein.

148 The formulation that I prefer is that given by Lord Diplock in *Photo Production Ltd. v. Securicor Tpt. Ltd.*, [1980] A.C. 827, [1980] 2 W.L.R. 283, [1980] 1 All E.R. 556 (H.L.). A fundamental breach occurs "Where the event resulting from the failure by one party to perform a primary obligation has the effect of depriving the other party of *substantially the whole benefit* which it was the intention of the parties that he should obtain from the contract" (p. 849)

(emphasis added). This is a restrictive definition and rightly so, I believe. As Lord Diplock points out, the usual remedy for breach of a "primary" contractual obligation (the thing bargained for) is a concomitant "secondary" obligation to pay damages. The other primary obligations of both parties yet unperformed remain in place. Fundamental breach represents an exception to this rule for it gives to the innocent party an additional remedy, an election to "put an end to all primary obligations of both parties remaining unperformed" (p. 849). It seems to me that this exceptional remedy should be available only in circumstances where the foundation of the contract has been undermined, where the very thing bargained for has not been provided.

149 I do not think the present case involves a fundamental breach. The trial judge had this to say on the question at pp. 77-78:

> As to the nature of the defect, in my opinion it was not so fundamental that it went to the root of the contract. The contract between the parties was still a contract for gearboxes. Gearboxes were supplied. They were capable of performing their function and did perform it for in excess of a year which, given the agreed time limitations, was the "cost free to Syncrude" period contemplated by the parties. It was conceded that the gearboxes were not fit for the service. However, the unfitness, or defect, was repairable and was repaired at a cost significantly less than the original purchase price. No doubt the bull gear is an important component of the gearbox but no more important than the engine in an automobile and in the *Gafco Ent.* case the failure of the engine was not a sufficiently fundamental breach to lead the Court to set aside the contract of sale. On my appreciation of the evidence Syncrude got what it bargained for from Stephens-Adamson. It has not convinced me that there was fundamental breach.

The Court of Appeal, in overturning this finding, seems to have been influenced by two factors: that the repair cost was 85 per cent of the original contract price and that the gear which should have lasted ten years failed after less than two. I will deal with each of these factors in turn.

150 There is an obvious conflict between the judgments below over the relationship between the size of the contract and the cost of repairs. The Court of Appeal treated the contract for the gearboxes as a discrete transaction in coming to its conclusion. The trial judge, however, was influenced by the fact that the overall contract with Allis-Chalmers was for 14 conveyor systems, only 4 of which contained extraction gearboxes. The total cost of these systems was in excess of $4 million. It seems to me that the trial judge was right to take this into account. If he was, then Allis-Chalmers breached only one aspect of its contract with Syncrude, one "primary obligation". Although the gears were obviously an important component of the conveyor system, their inferior performance did not have the effect of depriving Syncrude of "substantially the whole benefit of the contract" to use Lord Diplock's phrase. The cost of repair was only a small part of the total cost.

151 Syncrude bargained for and received bull gears. Clearly, they were not very good gears. They were not reasonably fit for the purposes they were intended to serve. But they did work for a period of time and were repairable. There are numerous cases in which serious but repairable defects in machinery of various kinds have been found not to amount to fundamental breach. In *Gafco Ent. Ltd. v. Schofield*, [1983] 4 W.W.R. 135, 25 Alta. L.R. (2d) 238, 23 B.L.R. 9, 43 A.R. 262 (C.A.), a case relied on by Gibbs J. in this case, the purchaser bought a second-hand car for $12,000 which immediately required some $4,000 worth of engine repairs. Harradence J.A. held that the defects "do not amount to a breach going to the root of the contract. They are repairable, albeit at some expense" (p. 267). Similarly, in *Peters v. Parkway Mercury Sales Ltd.* (1975), 58 D.L.R. (3d) 128, 10 N.B.R. (2d) 703 (C.A.), a transmission failure shortly after the expiration of a 30-day warranty on a used car was found not to be a fundamental breach. Hughes C.J.N.B. said at p. 711:

> In my view the car which the defendant sold the plaintiff was not essentially different in character from what the parties should have had in contemplation. Although the car was in poorer condition than either party probably knew, I do not think the defects amounted to "such a congeries of defects as to destroy the workable character of the machine" and consequently the plaintiff's claim for a declaration that there has been a fundamental breach entitling him to rescission if [sic] the contract fails.

In *Keefe v. Fort* (1978), 89 D.L.R. (3d) 275, 27 N.S.R. (2d) 353 (C.A.), another case involving a faulty but repairable car, Pace J.A. said at p. 279 that "the doctrine of fundamental breach was never intended to be applied to situations where the parties have received substantially what they had bargained for".

152 In the present case the Court of Appeal relied on its own prior judgment in *Beldessi v. Island Equip. Ltd.* (1973), 41 D.L.R. (3d) 147 (B.C.C.A.), which it said was "very similar" to this one (p. 390). *Beldessi*, however, involved a log skidding machine which, despite numerous repairs, never worked properly. It was therefore similar to *R.G. McLean Ltd. v. Can. Vickers Ltd.*, supra, in which a printing press could not be made to function adequately. It seems to me that the present case is more akin to those cited above where the purchaser got a poor, but nonetheless repairable, version of what it contracted for. I do not think that in these circumstances it can be said that the breach undermined the entire contractual setting or that it went to the very root of the contract. It was not, in other words, fundamental. I would therefore allow the appeal by Allis-Chalmers on this issue.

153 However, if I am wrong in this and the breach by Allis-Chalmers is properly characterized as fundamental, the liability of Allis-Chalmers would, in my view, be excluded by the terms of the contractual warranty.

154 Prior to 1980, in both the United Kingdom and in Canada, there were two competing views of the consequences of fundamental breach. One held that there was a rule of law that a fundamental breach brought a contract to an end, thereby preventing the contract breaker from relying on any clause exempting liability. This view was most closely identified with Lord Denning in the English Court of Appeal: see *Karsales (Harrow) Ltd. v. Wallis*, [1956] 1 W.L.R. 936, [1956] 2 All E.R. 866; *Harbutt's "Plasticine" Ltd. v. Wayne Tank & Pump Co.*, [1970] 1 Q.B. 447, [1970] 2 W.L.R. 198, [1970] 1 All E.R. 225. The other view was that exemption clauses should be construed by the same rules of contract interpretation whether a fundamental breach had occurred or not. Whether or not liability was excluded was to be decided simply on the construction of the contract: see *Suisse Atl.*, supra, *Traders Fin. Corp. v. Halverson* (1968), 2 D.L.R. (3d) 666 (B.C.C.A.); *R.G. McLean Ltd. v. Can. Vickers Ltd.*, supra.

155 In England the issue was unequivocally resolved by the House of Lords in favour of the construction approach in the *Photo Production* case. The defendants Securicor had contracted to provide security services for the plaintiff's factory. One of the security guards deliberately set a fire which destroyed the building. When sued, Securicor pleaded the following exemption clause:

> 1. Under no circumstances shall the company [Securicor] be responsible for any injurious act or default by any employee of the company unless such act or default could have been foreseen and avoided by the exercise of due diligence on the part of the company as his employer; nor, in any event, shall the company be held responsible for (a) Any loss suffered by the customer through burglary, theft, fire or any other cause, except insofar as such loss is solely attributable to the negligence of the company's employees acting within the course of their employment ...

Lord Wilberforce, on behalf of all the other Law Lords, stated succinctly at pp. 842-43:

> ... the question whether, and to what extent, an exclusion clause is to be applied to a fundamental breach, or a breach of a fundamental term, or indeed to any breach of contract, is a matter of construction of the contract.

Lord Wilberforce gave three reasons in support of this conclusion. Firstly, the rule of law approach was based on faulty reasoning. He said at p. 844:

> I have, indeed, been unable to understand how the doctrine can be reconciled with the well accepted principle of law, stated by the highest modern authority, that when in the context of a breach of contract one speaks of "termination," what is meant is no more than that the innocent party or, in some cases, both parties, are excused from further performance. Damages, in such cases, are then claimed under the contract, so what reason in principle can there be for disregarding what the contract itself says about damages — whether it "liquidates" them, or limits them, or excludes them?

Secondly, the courts should allow the parties to make their own bargain. The courts' role should be limited to upholding that bargain (p. 843):

> At the stage of negotiation as to the consequences of a breach, there is everything to be said for allowing the parties to estimate their respective claims according to the contractual provisions they have themselves made, rather than for facing them with a legal complex so uncertain as the doctrine of fundamental breach must be. What, for example, would have been the position of the respondents' factory if instead of being destroyed it had been damaged, slightly or moderately severely? At what point does the doctrine (with what logical justification I have not understood) decide, ex post facto, that the breach was (factually) fundamental before going on to ask whether legally it is to be regarded as fundamental? How is the date of "termination" to be fixed? Is it the date of the incident causing the damage, or the date of the innocent party's election, or some other date? All these difficulties arise from the doctrine and are left unsolved by it.
>
> At the judicial stage there is still more to be said for leaving cases to be decided straightforwardly on what the parties have bargained for rather than upon analysis, which becomes progressively more refined, of decisions in other cases leading to inevitable appeals.

Lord Diplock in his concurring reasons stressed that parties of equal bargaining power should be allowed to make their own bargains. He said at p. 851:

> In commercial contracts negotiated between business-men capable of looking after their own interests and of deciding how risks inherent in the performance of various kinds of contract can be most economically borne (generally by insurance), it is, in my view, wrong to place a strained construction upon words in an exclusion clause which are clear and fairly susceptible of one meaning only ...

Thirdly, Lord Wilberforce, while recognizing that fundamental breach "has served a useful purpose" in the area of consumer and standard form contracts, found that legislation in the form of the Unfair Contract Terms Act, 1977 (U.K.), c. 50, had taken the place of judicial intervention in that area. He noted at p. 843 that the Act "applies to consumer contracts and those based on standard terms and enables exception clauses to be applied with regard to what is just and reasonable". For the future, the courts did not need to lay down rules to cover such situations and should refrain from doing so in other circumstances (p. 843):

> It is significant that Parliament refrained from legislating over the whole field of contract. After this Act, in commercial matters generally, when the parties are not of unequal bargaining power, and when risks are normally borne by insurance, not only is the case for judicial intervention undemonstrated, but there is everything to be said, and this seems to have been Parliament's intention, for leaving the parties free to apportion the risks as they think fit and for respecting their decisions.

Lord Wilberforce concluded that the exemption clause in the case, even interpreted contra proferentem, was sufficiently clear to exclude liability.

156 The construction approach to exclusionary clauses in the face of a fundamental breach affirmed in *Photo Production* was adopted by this court as the law in Canada in *Beaufort Realties (1964) Inc. v. Chomedey Aluminum Co.*, [1980] 2 S.C.R. 718, 15 R.P.R. 62, 116 D.L.R. (3d) 193, *(*sub nom. *Beaufort Realties (1964) Inc. v. Belcourt Const. (Ottawa) Ltd.)* 33 N.R. 460 [Ont.]. The court did not, however, reject the concept of fundamental breach. The respondent entered into a construction contract with Beaufort in which it agreed to waive all liens for work and materials provided in the event of a failure to make payments. Such a failure took place and Justice Ritchie had no difficulty in concluding that the failure constituted a fundamental breach. He adopted Lord Wilberforce's construction approach to the exclusion clause and stated at p. 725 "that the question of whether such a clause was applicable where there was a fundamental breach was to be determined according to the true construction of the contract".

157 As Professor Waddams noted (see (1981), 15 Univ. of B.C. L. Rev. 189) shortly after this court's decision in *Beaufort Realties*:

> ... the Supreme Court of Canada followed the House of Lords in holding that there is no rule of law preventing the operation of exclusionary clauses in cases of fundamental breach of contract. The effect of such clauses is now said to depend in each case on the true construction of the contract.

158 Thus, the law in Canada on this point appears to be settled. Some uncertainty, however, does remain primarily with regard to the application of the construction approach. Some decisions of our courts clearly follow the construction approach in both theory and practice. In *Hayward v. Mellick* (1984), 45 O.R. (2d) 110, 26 B.L.R. 156, 5 D.L.R. (4th) 740, 2 O.A.C. 161 (C.A.), for example, Weatherston J.A. noted that as "the courts of this province adopted the doctrine from the English courts, I think we should now follow their lead in rejecting it as a rule of law" (p. 168). Even when the exclusion clause in issue was "strictly construed" Weatherston J.A. recognized at p. 168 that "it would be too strained a construction of the disclaimer clause to say that it applies only to representations that are not negligent. I think that effect must be given to it". He went on to hold that the exclusion clause in that case was sufficient to cover any breach of contract.

159 Commentators seem to be in agreement, however, that the courts, while paying lip service to the construction approach, have continued to apply a modified "rule of law" doctrine in some cases. Professor Fridman in Law of Contract in Canada has suggested at p. 558 that:

> Under the guise of "construction", some courts appear to be utilizing something very much akin to the "rule of law" doctrine. What Canadian courts may be doing is to apply a concept of "fair and reasonable" construction in relation to the survival of the exclusion clause after a fundamental breach, and the application of such a clause where the breach in question involves not just a negligent performance of the contract, but the complete failure of the party obliged to fulfil the contract in any way whatsoever.

Professor Ogilvie, in a review of Canadian cases decided shortly after *Photo Production*, including *Beaufort Realties* itself, argues that the rule of law approach "has been replaced by a substantive test of reasonableness which bestows on the courts at least as much judicial discretion to intervene in contractual relationships as fundamental breach ever did": see Ogilvie, "The Reception of *Photo Production Ltd. v. Securicor Transport Ltd.* in Canada: *Nec Tamen Consumebatur*" (1982), 27 McGill L.J. 424, at p. 441.

160 Little is to be gained from a review of the recent cases which have inspired these comments. Suffice it to say that the law in this area seems to be in need of clarification. The uncertainty might be resolved in either of two ways. The first way would be to adopt *Photo Production* in its entirety. This would include discarding the concept of fundamental breach. The courts would give effect to exclusion clauses on their true construction regardless of the nature of the breach. Even the party who had committed a breach such that the foundation of the contract was undermined and the very thing bargained for not provided could rely on provisions in the contract limiting or excluding his or her liability. The only relevant question for the court would be: on a true and natural construction of the provisions of the contract, did the parties, *at the time the contract was made*, succeed in excluding liability? This approach would have the merit of importing greater simplicity into the law and consequently greater certainty into commercial dealings, although the results of enforcing such exclusion clauses could be harsh if the parties had not adequately anticipated or considered the possibility of the contract's disintegration through fundamental breach.

161 The other way would be to import some "reasonableness" requirement into the law so that courts could refuse to enforce exclusion clauses in strict accordance with their terms if to do so would be unfair and unreasonable. One far-reaching "reasonableness" requirement which I would reject (and which I believe was rejected in *Beaufort Realties* both by this court and the Ontario Court of Appeal) would be to require that the exclusion clause be per se a fair and reasonable contractual term in the contractual setting or bargain made by the parties. I would reject this approach

because the courts, in my view, are quite unsuited to assess the fairness or reasonableness of contractual provisions as the parties negotiated them. Too many elements are involved in such an assessment, some of them quite subjective. It was partly for this reason that this court in *Beaufort Realties* and the House of Lords in *Photo Productions* clearly stated that exclusion clauses, like all contractual provisions, should be given their natural and true construction. Great uncertainty and needless complications in the drafting of contracts will obviously result if courts give exclusion clauses strained and artificial interpretations in order, indirectly and obliquely, to avoid the impact of what seems to them ex post facto to have been an unfair and unreasonable clause.

162 I would accordingly reject the concept that an exclusion clause in order to be enforceable must be per se a fair and reasonable provision at the time it was negotiated. The exclusion clause cannot be considered in isolation from the other provisions of the contract and the circumstances in which it was entered into. The purchaser may have been prepared to assume some risk if he could get the article at a modest price or if he was very anxious to get it. Conversely, if he was having to pay a high price for the article and had to be talked into the purchase, he may have been concerned to impose the broadest possible liability on his vendor. A contractual provision that seems unfair to a third party may have been the product of hard bargaining between the parties and, in my view, deserves to be enforced by the courts in accordance with its terms.

163 It is, however, in my view an entirely different matter for the courts to determine *after a particular breach has occurred* whether an exclusion clause should be enforced or not. This, I believe, was the issue addressed by this court in *Beaufort Realties*. In *Beaufort* this court accepted the proposition enunciated in *Photo Production* that no rule of law invalidated or extinguished exclusion clauses in the event of fundamental breach but rather that they should be given their natural and true construction so that the parties' agreement would be given effect. Nevertheless the court, in approving the approach taken by the Ontario Court of Appeal in *Beaufort*, recognized at the same time the need for courts to determine whether *in the context of the particular breach which had occurred* it was fair and reasonable to enforce the clause in favour of the party who had committed that breach even if the exclusion clause was clear and unambiguous. The relevant question for the court in *Beaufort* was: is it fair and reasonable in the context of this fundamental breach that the exclusion clause continue to operate for the benefit of the party responsible for the fundamental breach? In other words, should a party be able to commit a fundamental breach secure in the knowledge that no liability can attend it? Or should there be room for the courts to say: this party is now trying to have his cake and eat it too. He is seeking to escape almost entirely the burdens of the transaction but enlist the support of the courts to enforce its benefits.

164 It seems to me that the House of Lords was able to come to a decision in *Photo Production* untrammelled by the need to reconcile the competing values sought to be advanced in a system of contract law such as ours. We do not have in this country legislation comparable to the United Kingdom's Unfair Contract Terms Act, 1977. I believe that in the absence of such legislation Canadian courts must continue to develop through the common law a balance between the obvious desirability of allowing the parties to make their own bargains and have them enforced through the courts and the obvious undesirability of having the courts used to enforce bargains in favour of parties who are totally repudiating such bargains themselves. I fully agree with the commentators that the balance which the courts reach will be made much clearer if we do not clothe our reasoning "in the guise of interpretation". Exclusion clauses do not automatically lose their validity in the event of a fundamental breach by virtue of some hard and fast rule of law. They should be given their natural and true construction so that the meaning and effect of the exclusion clause the parties agreed to at the time the contract was entered into is fully understood and appreciated. But, in my view, the court must still decide, having ascertained the parties' intention at the time the contract was made, whether or not to give effect to it in the context of subsequent events such as a fundamental breach committed by the party seeking its enforcement through the courts. Whether the courts address this narrowly in terms of fairness as between the parties (and I believe this has been a source of confusion, the parties being, in the absence of inequality of bargaining power, the best judges of what is fair as between themselves) or on the broader policy basis of the need for the courts (apart from the interests of the parties) to balance conflicting values inherent in our contract law (the approach which I prefer), I believe the result will be the same since the question essentially is: in the circumstances that have happened, should the court lend its aid to A to hold B to this clause?

165 In affirming the legitimate role of our courts at common law to decide whether or not to enforce an exclusion clause in the event of a fundamental breach, I am not unmindful of the fact that means are available to render exclusion clauses unenforceable even in the absence of a finding of fundamental breach. While we do not have legislation comparable to the United Kingdom's Unfair Contract Terms Act, 1977, we do have some legislative protection in this area. Six provinces prevent sellers from excluding their obligations under Sale of Goods Acts where consumer sales are concerned: see Consumer Protection Act, R.S.O. 1980, c. 87, s. 34(1); Consumer Protection Act, R.S.N.S. 1967, c. 53, s. 20C, as amended by S.N.S. 1975, c. 19; Consumer Protection Act, R.S.M. 1970, c. C200, s. 58(1); Sale of Goods Act, R.S.B.C. 1979, c. 370, s. 20; Consumer Product Warranty and Liability Act, S.N.B. 1978, c. C-18.1, ss. 24-26 (except insofar as an exclusion is fair and reasonable); Consumer Products Warranties Act, R.S.S. 1978, c. C-30, ss. 8 and 11. In addition, some provinces have legislation dealing with unfair business practices which affects the application of some exclusion clauses: see Business Practices Act, R.S.O. 1980, c. 55, s. 2(*b*)(vi); Trade Practice Act, R.S.B.C. 1979, c. 406, s. 4(*e*); Unfair Trade Practices Act, R.S.A. 1980, c. U-3, s. 4(*b*), (*d*); Trade Practices Inquiry Act, R.S.M. 1987, c. T110, s. 2; Trade Practices Act, S.N. 1978, c. 10, s. 6(*d*); Business Practices Act, S.P.E.I. 1977, c. 31, s. 3(*b*)(vi). Such legislation, in effect, imposes limits on freedom of contract for policy reasons.

166 There are, moreover, other avenues in our law through which the courts (as opposed to the legislatures) can control the impact of exclusion clauses in appropriate circumstances. Fundamental breach has its origins in that aspect of the doctrine of unconscionability which deals with inequality of bargaining power: see Waddams, "Unconscionability in Contracts" (1976), 39 Modern L. Rev. 369. As Professor Ziegel notes in Comment (1979), 57 Can. Bar Rev. 105, at p. 113:

> The initial impulse that prompted the development of the doctrine of fundamental breach was very sound insofar as it was designed to prevent overreaching of a weaker party by a stronger party. The impulse became distorted when subsequent courts confused cause and effect and treated the doctrine, albeit covertly, as expressing a conclusive rule of public policy regardless of the circumstances of the particular case. *What is needed therefore is a return to a regime of natural construction coupled with an explicit test of unfairness tailored to meet the facts of particular cases.* [emphasis added]

167 The availability of a plea of unconscionability in circumstances where the contractual term is per se unreasonable *and* the unreasonableness stems from inequality of bargaining power was confirmed in Canada over a century ago in *Waters v. Donnelly* (1884), 9 O.R. 391 (Ch.). It has been used on many subsequent occasions: see *Morrison v. Coast Fin. Ltd.* (1965), 54 W.W.R. 257, 55 D.L.R. (2d) 710 (B.C.C.A.); *Harry v. Kreutziger* (1978), 9 B.C.L.R. 166, 95 D.L.R. (3d) 231 (C.A.); *Taylor v. Armstrong* (1979), 24 O.R. (2d) 614, 99 D.L.R. (3d) 547 (H.C.).

168 While this is perhaps not the place for a detailed examination of the doctrine of unconscionability as it relates to exclusion clauses, I believe that the equitable principles on which the doctrine is based are broad enough to cover many of the factual situations which have perhaps deservedly attracted the application of the "fair and reasonable" approach in cases of fundamental breach. In particular, the circumstances surrounding the making of a consumer standard form contract could permit the purchaser to argue that it would be unconscionable to enforce an exclusion clause. *Davidson v. Three Spruces Realty Ltd.; Farr v. Three Spruces Realty Ltd.; Elsdon v. Three Spruces Realty Ltd.*, [1977] 6 W.W.R. 460, 79 D.L.R. (3d) 481 (B.C.S.C.), is a case in point. The plaintiff and others deposited valuables with the defendants. When they were stolen as a result of the latter's negligence, a broad exclusion clause was pleaded. Anderson J. found the defendant liable for fundamental breach and for misrepresentation but he also expressed the view that the exclusion clause should not be applied because of unconscionability. He said at pp. 492-93:

> Counsel for the bailee submits that the Courts should not interfere with freedom of contract. He submits that if the parties to contracts are not held to the terms of their bargain, however harsh or one-sided, the element of certainty so important in the commercial world will be eliminated. He submits that the plaintiffs agreed in writing, in clear terms, that the bailee would not be responsible for any negligence on its part ...

> I agree that as a general rule, apart from fraud, it would be a dangerous thing to hold that contracts freely entered into should not be fully enforced. It is not correct, however, to suppose that there are no limitations on freedom of contract. The point has been reached in the development of the common law where, in my opinion, the Courts may say, in certain circumstances, that the terms of a contract, although perfectly clear, will not be enforced because they are entirely unreasonable ...
>
> I take the view that the Courts are not bound to accept all contracts at face value and enforce those contracts without some regard to the surrounding circumstances. I do not think that standard form contracts should be construed in a vacuum. I do not think that mere formal consensus is enough. *I am of the opinion that the terms of a contract may be declared to be void as being unreasonable where it can be said that in all the circumstances it is unreasonable and unconscionable to bind the parties to their formal bargain.* [emphasis added]

He concluded at p. 494:

> (c) Even if the limitation clause was such as to protect the bailee against conduct amounting to a fundamental breach, the clause is, in all the circumstances, so offensive to all right-thinking persons that the Courts will hold that to allow the bailee to rely on the limitation clause would be unconscionable and an abuse of freedom of contract.

Anderson J. suggested the following criteria, at p. 493, to ascertain whether " 'freedom of contract has been abused' so as to make it unconscionable for the bailee to exempt itself from liability":

> (1) Was the contract a standard form contract drawn up by the bailee?
>
> (2) Were there any negotiations as to the terms of the contract or was it a commercial form which may be described as a "sign here" contract?
>
> (3) Was the attention of the plaintiffs drawn to the limitation clause?
>
> (4) Was the exemption clause unusual in character?
>
> (5) Were representations made which would lead an ordinary person to believe that the limitation clause did not apply?
>
> (6) Was the language of the contract when read in conjunction with the limitation clause such as to render the implied covenant made by the bailee to use reasonable care to protect the plaintiffs' property meaningless?
>
> (7) Having regard to all the facts including the representations made by the bailee and the circumstances leading up to the execution of the contract, would not the enforcement of the limitation clause be a tacit approval by the Courts of unacceptable commercial practices?

Anderson J.'s judgment in *Davidson* drew on *Gillespie Bros. & Co. v. Roy Bowles Tpt. Ltd.*, [1973] Q.B. 400, [1972] 3 W.L.R. 1003, [1973] 1 All E.R. 193 (C.A.), in which Lord Denning said at pp. 415-16:

> The time may come when this process of "construing" the contract can be pursued no further. The words are too clear to permit of it. Are the courts then powerless? Are they to permit the party to enforce his unreasonable clause, even when it is so unreasonable, or applied so unreasonably, as to be unconscionable? When it gets to this point, I would say, as I said many years ago: "*there is the vigilance of the common law which, while allowing freedom of contract, watches to see that it is not abused*": *John Lee & Son (Grantham) Ltd. v. Railway Executive*, [1949] 2 All E.R. 581, 584. It will not allow a party to exempt himself from his liability at common law when it would be quite unconscionable for him to do so. [emphasis added]

169 As I have noted, this is not the place for an exposition of the doctrine of unconscionability as it relates to inequality of bargaining power and I do not necessarily endorse the approaches taken in the cases to which I have just referred. I use them merely to illustrate the broader point that in situations involving contractual terms which result from inequality of bargaining power the judicial armory has weapons apart from strained and artificial constructions of exclusion clauses. Where, however, there is no such inequality of bargaining power (as in the present case) the courts should, as a general rule, give effect to the bargain freely negotiated by the parties. The question is whether this is an absolute rule or whether as a policy matter the courts should have the power to refuse to enforce a clear and unambiguous exclusion clause freely negotiated by parties of equal bargaining power and, if so, in what circumstances? In the present state of the law in Canada the doctrine of fundamental breach provides one answer.

170 To dispense with the doctrine of fundamental breach and rely solely on the principle of unconscionability, as has been suggested by some commentators, would, in my view, require an extension of the principle of unconscionability beyond its traditional bounds of inequality of bargaining power. The court, in effect, would be in the position of saying that terms freely negotiated by parties of equal bargaining power were unconscionable. Yet it was the inequality of bargaining power which traditionally was the source of the unconscionability. What was unconscionable was to permit the strong to take advantage of the weak in the making of the contract. Remove the inequality and we must ask, wherein lies the unconscionability? It seems to me that it must have its roots in subsequent events, given that the parties themselves are the best judges of what is fair at the time they make their bargain. The policy of the common law is, I believe, that having regard to the conduct (pursuant to the contract) of the party seeking the indulgence of the court to enforce the clause, the court refuses. This conduct is described for convenience as "fundamental breach". It marks off the boundaries of tolerable conduct. But the boundaries are admittedly uncertain. Will replacing it with a general concept of unconscionability reduce the uncertainty?

171 When and in what circumstances will an exclusion clause in a contract freely negotiated by parties of equal bargaining power be unconscionable? If both fundamental breach and unconscionability are properly viewed as legal tools designed to relieve parties in light of subsequent events from the harsh consequences of an automatic enforcement of an exclusion clause in accordance with its terms, is there anything to choose between them as far as certainty in the law is concerned? Arguably, unconscionability is even less certain than fundamental breach. Indeed, it may be described as "the length of the Chancellor's foot". Lord Wilberforce may be right that parties of equal bargaining power should be left to live with their bargains regardless of subsequent events. I believe, however, that there is some virtue in a residual power residing in the court to withhold its assistance on policy grounds in appropriate circumstances.

172 Turning to the case at bar, it seems to me that, even if the breach of contract was a fundamental one, there would be nothing unfair or unreasonable (and even less so unconscionable, if this is a stricter test) in giving effect to the exclusion clause. The contract was made between two companies in the commercial market-place who are of roughly equal bargaining power. Both are familiar and experienced with this type of contract. As the trial judge noted (27 B.L.R. 59 at 77):

> Warranty cl. 8 was put forward by Syncrude. Presumably it provided the protection Syncrude wanted. Indeed, the first sentence thereof is sufficiently all-embracing that it is difficult to conceive of a defect which would not be caught by it. Syncrude freely accepted the time limitations; there is no evidence that they were under any disadvantage or disability in the negotiating of them. There is no reason why they should not be held to their bargain, including that part of which effectively excludes the implied condition of s. 15(1) of the Ontario Sale of Goods Act.

There is no evidence to suggest that Allis-Chalmers, who seeks to rely on the exclusion clause, was guilty of any sharp or unfair dealing. It supplied what was bargained for (even although it had defects) and its contractual relationship with Syncrude, which included not only the gears but the entire conveyor system, continued on after the supply of the gears. It cannot be said, in Lord Diplock's words, that Syncrude was "deprived of substantially the whole benefit" of the contract. This is not a case in which the vendor or supplier was seeking to repudiate almost entirely the burdens of the transaction and invoking the assistance of the courts to enforce its benefits. There is no abuse of freedom of contract here.

173 In deciding to enforce the exclusion clause, the trial judge relied in part on the fact that the exclusion clause limited but did not completely exclude the liability of Allis-Chalmers (p. 77). In relying on this fact, the trial judge was supported by some dicta of Lord Wilberforce in the House of Lords in *Ailsa Craig Fishing Co. v. Malvern Fishing Co.*, [1983] 1 W.L.R. 964, [1983] 1 All E.R. 101 at 102-103 (H.L.). It seems to me, however, that any categorical distinction between clauses limiting and clauses excluding liability is inherently unreliable in that, depending on the circumstances, "exclusions can be perfectly fair and limitations very unfair": Waddams, The Law of Contracts, 2nd ed. (1984), at p. 349. It is preferable, I believe, to determine whether or not the impugned clause should be enforced in all the circumstances of the case and avoid reliance on awkward and artificial labels. When this is done, it becomes clear that there is no reason in this case not to enforce the clause excluding the statutory warranty.

(iv) The trust fund

174 This issue arises from a cross-appeal by Syncrude against the Court of Appeal's decision to award the fund to Hunter U.S., minus administration expenses and the cost — $200,000 plus interest — of repairing the gearboxes built under the ACO contract. Hunter U.S. does not contest this latter aspect of the Court of Appeal's decision. ACO has been paid and the balance of $0.5 million left in the fund after the payment of ACO represents Hunter Canada's profit margin on its contract with Syncrude plus the income earned on that profit margin. In my view it was not correct to hold, as the trial judge did, that the fund should only be disposed of according to the terms of the trust agreement. The trust terms were not agreed upon by these parties. The trust was unilaterally established by Syncrude on a kind of interpleader basis, the object of creating the trust being to avoid prejudging the outcome of the litigation bet ween Hunter Canada and Hunter U.S. Syncrude was perfectly prepared to acknowledge in 1978 that the profit margin was payable to one of these two parties. The only question was which one. It is no longer prepared to acknowledge this. In such circumstances I agree with the Court of Appeal that the entitlement to the trust fund should be decided on the equitable principles governing unjust enrichment.

175 In *Pettkus v. Becker*, [1980] 2 S.C.R. 834, 19 R.F.L. (2d) 165, 8 E.T.R. 143, 117 D.L.R. (3d) 257, 34 N.R. 384 [Ont.], Dickson J. (as he then was) said at pp. 847-48:

> "Unjust enrichment" has played a role in Anglo-American legal writing for centuries. Lord Mansfield, in the case of *Moses v. Macferlan* put the matter in these words: "... the gist of this kind of action is, that the defendant, upon the circumstances of the case, is *obliged by the ties of natural justice and equity to refund* the money". It would be undesirable and indeed impossible, to attempt to define all the circumstances in which an unjust enrichment might arise ... The great advantage of ancient principles of equity is their flexibility: the judiciary is thus able to shape these malleable principles so as to accommodate the changing needs and mores of society, in order to achieve justice ...
>
> ... there are three requirements to be satisfied before an unjust enrichment can be said to exist: an enrichment, a corresponding deprivation and absence of any juristic reason for the enrichment. This approach, it seems to me, is supported by general principles of equity that have been fashioned by the courts for centuries ...

These principles were unanimously affirmed by this court in *Sorochan v. Sorochan*, [1986] 2 S.C.R. 38, [1986] 5 W.W.R. 289, 46 Alta. L.R. (2d) 97, 2 R.F.L. (3d) 225, 23 E.T.R. 143, 29 D.L.R. (4th) 1, [1986] R.D.I. 448, [1986] R.D.F. 501, 74 A.R. 67, 69 N.R. 81. Although both *Pettkus v. Becker* and *Sorochan v. Sorochan* were "family" cases, unjust enrichment giving rise to a constructive trust is by no means confined to such cases: see *Deglman v. Guar. Trust Co.*, [1954] S.C.R. 725, [1954] 3 D.L.R. 785 [Ont.]. Indeed, to do so would be to impede the growth and impair the flexibility crucial to the development of equitable principles.

176 It is necessary to ask first whether Syncrude will be enriched if allowed to retain the trust fund. Clearly it will because it will receive interest income on money that it intended initially to pay to Hunter Canada. One need only look to the terms of the fund itself to appreciate this. I reproduce cl. 7, which states:

7. Following the payments made pursuant to clauses 5 and 9, the trustee shall hold *the remainder of the trust funds and trust income for payment* pending determination by agreement *between Hunter Canada and Hunter Engineering*, or by a decision of a Court of competent jurisdiction in Canada as to the identity of the holder of a valid and lawful interest in the remainder of trust funds as between Hunter Engineering and Hunter Canada, or upon determination of certain issues in Canada, currently the subject of legal proceedings between Hunter Engineering and Hunter Canada by settlement agreement or by a decision of a Court of competent jurisdiction in Canada. [emphasis added]

As already mentioned, Syncrude in 1978 considered itself bound to pay the Hunter Canada profit to either Hunter Canada or Hunter U.S. Syncrude's entitlement is limited to working gearboxes at the price agreed upon and, provided repair costs are paid out of the fund, it will get precisely that. Any additional money arising out of the circumstances surrounding the contract with ACO will constitute an enrichment.

177 I am likewise of the opinion that, if Syncrude is permitted to keep the entire fund, Hunter U.S. will be correspondingly deprived of the interest income it would have earned on the contract for the supply of the additional 11 mining gearboxes. I agree with the Court of Appeal that there need not be a contractual link for the causal connection between contribution and enrichment to be proved. This is a question to be decided on the facts of each case since the remedy of constructive trust is a discretionary one imposed as and when equity requires it. In this case there is sufficient causal connection in the fact that Hunter U.S. first offered to assume the whole Hunter Canada contract and later, after it won its case, was prepared to offer Syncrude the warranty terms under which the original 32 gearboxes were supplied. Its latter offer was not unreasonable in the circumstances, even though I believe that it should be held in equity to the warranty clause in the Hunter Canada contract. In any event, the arguments over warranties are now irrelevant, given that Hunter U.S. would be liable under both the Hunter Canada warranty and the implied statutory warranty.

178 In his presentation before this court, Mr. Kirkham, counsel for Syncrude, contended that Hunter U.S. had not suffered a deprivation because it did nothing to facilitate the supply of the gearboxes. ACO fabricated them from the designs in Syncrude's possession, the designs having been obtained from Hunter U.S. at the time of the first contract. Syncrude, because it supplied the designs, had to accept a very limited warranty from ACO, one that did not extend to any aspect of the design or specifications. Unfortunately, there is no finding of fact below as to the ownership of these designs and the evidence on the matter is contradictory. I believe, however, that Mr. Kirkham's arguments can be refuted without deciding that issue. The main difficulty with his argument is that they are based on an ex post facto view of the various circumstances. Whether or not Syncrude "owned" the designs when it contracted with Hunter Canada, the fact is that Syncrude willingly entered into that contract *at the time*. It was also prepared to pay a profit margin to Hunter U.S. after the passing-off litigation had been resolved. It may be the case, as counsel for Syncrude submitted, that Hunter U.S. made no contribution to the ACO contract. But Syncrude was ready in 1978 to pay the principal contractor's portion to Hunter U.S. and cannot now argue that it had no need of Hunter U.S.

179 Except for the point about ownership of the drawings, counsel for Syncrude suggested no juristic reason for the enrichment and I can think of none. I would therefore agree with the Court of Appeal that, provided Hunter U.S. accepts the warranty terms of the Hunter Canada contract and pays for the cost of repairing the 11 gearboxes, the trust fund minus administration expenses belongs in equity to Hunter U.S.

4. Disposition

180 I would dispose of the appeal and cross-appeal as follows:

181 (i) The appeal of Hunter U.S. against the finding of liability for design default is dismissed. Hunter U.S. breached its statutory warranty under s. 15(1) of the Sale of Goods Act in respect of the design default in the 32 mining gearboxes and must pay to Syncrude the sum of $750,000 in respect thereof plus prejudgment interest in the amount of $250,000.

182 (ii) The appeal of Allis-Chalmers against the finding of fundamental breach is allowed. The breach was not fundamental but, even if it were, Allis-Chalmers was insulated from liability for it by the exclusion clause. Since Allis-

Chalmers incurs no liability to Syncrude in respect of the design default in the four extraction gearboxes, it has no claim over against Hunter U.S. in respect thereof and its third party claim is accordingly dismissed.

183 (iii) The cross-appeal by Syncrude claiming ownership of the trust fund is dismissed. Hunter U.S. is entitled to the balance in the trust fund after administration costs and the cost of repairs to the 32 mining gearboxes have been satisfied out of it.

5. Costs

184 Allis-Chalmers should have its costs against Syncrude both here and in the Court of Appeal. As between Hunter U.S. and Syncrude success in this court was divided. Hunter U.S. lost on the main issue of its liability for design default in respect of the 32 mining gearboxes but shared success with Allis-Chalmers on the issue of fundamental breach and the effect of the exclusion clause in the Allis-Chalmers contract. It was also successful in its claim to the balance in the trust fund. I would make no order as to costs as between Hunter U.S. and Syncrude.

First defendant's appeal dismissed; second defendant's appeal allowed; plaintiffs' cross-appeal allowed.

Footnotes

* Estey and Le Dain JJ. took no part in the judgment.

** Estey and Le Dain JJ. took no part in the judgment.

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TAB 14

2005 CarswellOnt 4019
Ontario Court of Appeal

Toronto Transit Commission v. Gottardo Construction Ltd.

2005 CarswellOnt 4019, [2005] O.J. No. 3689, 142 A.C.W.S. (3d) 79, 202 O.A.C. 178, 257 D.L.R. (4th) 539, 45 C.L.R. (3d) 301, 77 O.R. (3d) 269, 8 B.L.R. (4th) 173

TORONTO TRANSIT COMMISSION (Plaintiff / Appellant / Respondent by Cross-Appeal) and GOTTARDO CONSTRUCTION LIMITED and CGU INSURANCE COMPANY OF CANADA (Defendants / Respondents / Appellants by Cross-Appeal)

Borins, Feldman, Rouleau JJ.A.

Heard: June 21, 2004
Judgment: September 7, 2005
Docket: CA C41246

Proceedings: reversing *Toronto Transit Commission v. Gottardo Construction Ltd.* (2003), 32 C.L.R. (3d) 272, 2003 CarswellOnt 5565, 45 B.L.R. (3d) 43, 68 O.R. (3d) 356 (Ont. S.C.J.)

Counsel: Harvey J. Kirsh, Roger Gillott for Toronto Transit Commission
H. James Marin, Wendy R. Cole for Gottardo Construction Limited
Matthew R. Alter for CGU Insurance Company of Canada

Subject: Contracts

Headnote

Construction law --- Contracts — Building contracts — Execution of formal contract — Tendering process — Process and procedure

Contractor was awarded Transit Commission construction project after submitting lowest bid — Contractor made arithmetic error resulting in bid being substantially understated — Commission refused to allow contractor to withdraw bid — Contractor refused to comply with demand for further documents or execute contract — Commission brought action against contractor and bonding company for damages — Trial judge dismissed action, holding that first contract, Contract A, did not come into existence upon mere submission of bid and that error existed on face of tender documents so as to prevent formation or enforcement of Contract A — Commission appealed — Appeal allowed — Acceptance or rejection of bid is not what leads to creation of Contract A, but rather, it is end point of tender process — Once tender is accepted, parties enter into construction contract referred to as Contract B — Fact that certain documents are to be produced by tenderer after submission and opening of tenders will not delay formation of Contract A when clear intent of parties is to be bound as of opening of tenders — Documents showed parties intended to initiate contractual relations the moment that tenders were opened — Cost summary indicating different total tender price was provided after Contract A was formed and was completed in non-compliant manner with tender instructions — No error was apparent on face of tender.

Construction law --- Contracts — Building contracts — Mistake

Rescission — Contractor was awarded Transit Commission construction project after submitting lowest bid — Contractor made arithmetic error resulting in bid being substantially understated — Commission refused to allow contractor to withdraw bid — Contractor refused to comply with demand for further documents or execute contract — Commission brought action against contractor and bonding company for damages — Trial judge dismissed

action, holding that first contract, Contract A, did not come into existence upon mere submission of bid and that error existed on face of tender documents so as to prevent formation or enforcement of Contract A — Commission appealed — Appeal allowed — Contractor was in breach of contract and was liable for damages — Contractor not entitled to rescission — Mistake was unilateral and no fraud existed — Financial hardship not sufficient to warrant rescission — Burden imposed on contractor by enforcement of contract, which was freely entered into, was not so grossly disproportionate so as to make enforcement of it by courts unconscionable — No grounds existed for equitable intervention.

Table of Authorities

Cases considered by *Rouleau J.A.*:

M.J.B. Enterprises Ltd. v. Defence Construction (1951) Ltd. (1999), 170 D.L.R. (4th) 577, 237 N.R. 334, 44 C.L.R. (2d) 163, 232 A.R. 360, 195 W.A.C. 360, 1999 CarswellAlta 301, 1999 CarswellAlta 302, [1999] 1 S.C.R. 619, [1999] 7 W.W.R. 681, 69 Alta. L.R. (3d) 341, 3 M.P.L.R. (3d) 165, 49 B.L.R. (2d) 1, 15 Const. L.J. 455, 2 T.C.L.R. 235 (S.C.C.) — considered

Martel Building Ltd. v. R. (2000), 2000 SCC 60, 2000 CarswellNat 2678, 2000 CarswellNat 2679, 36 R.P.R. (3d) 175, (sub nom. *Martel Building Ltd. v. Canada)* 193 D.L.R. (4th) 1, (sub nom. *Martel Building Ltd. v. Canada)* 262 N.R. 285, 3 C.C.L.T. (3d) 1, 5 C.L.R. (3d) 161, 186 F.T.R. 231 (note), (sub nom. *Martel Building Ltd. v. Canada)* [2000] 2 S.C.R. 860 (S.C.C.) — considered

R. v. Ron Engineering & Construction (Eastern) Ltd. (1981), 13 B.L.R. 72, 119 D.L.R. (3d) 267, [1981] 1 S.C.R. 111, (sub nom. *Ron Engineering & Construction (Eastern) Ltd. v. Ontario)* 35 N.R. 40, 1981 CarswellOnt 109, 1981 CarswellOnt 602 (S.C.C.) — considered

APPEAL by Transit Commission from judgment reported at *Toronto Transit Commission v. Gottardo Construction Ltd.* (2003), 32 C.L.R. (3d) 272, 2003 CarswellOnt 5565, 45 B.L.R. (3d) 43, 68 O.R. (3d) 356 (Ont. S.C.J.), dismissing action for damages against contractor and bonding company for breach of tender contract.

***Rouleau J.A.*:**

1 On December 20, 2000, the Toronto Transit Commission (TTC) opened the tenders it had received for a major project. Gottardo Construction Limited (Gottardo) was the lowest bidder. Shortly after the tenders were made public, Gottardo advised the TTC that it had made a $557,000 error in the tender amount. Gottardo maintained that, because of the error it was not obligated to honour the tender price of $4,811,000. The TTC took the position that Gottardo was bound. When Gottardo refused to sign the contract, the TTC awarded the contract to the next lowest bidder and sued Gottardo claiming, among other alternative relief, damages of $434,000, being the difference between Gottardo's tender price and the price at which the work was ultimately carried out. CGU Insurance Company of Canada (CGU) was also sued by TTC, as it was the company that had issued Gottardo's bid bond.

2 The trial judge found that the TTC's tender instructions were such that a first contract, referred to in the case law as "Contract A", had not come into existence upon the opening of the sealed tenders. Additional documents had to be provided by Gottardo before Contract A came into existence. These additional documents were required by the tender instructions. Once the documents were provided to the TTC, it was apparent that an error had been made in the tender amount. The trial judge found that Gottardo's mistake was discernable on the face of the documents before the formation of Contract A, and therefore that the TTC could not compel Gottardo to honour the price and could not recover against CGU on the bid bond. Consequently, she dismissed TTC's claim against Gottardo and CGU.

3 The trial judge, in *obiter*, went on to find that even if she was wrong, and Contract A was formed before the error became apparent, she would have granted Gottardo rescission on equitable grounds. She also would have relieved CGU of any obligation under the bid bond since the instructions to tenderers did not contain an explicit forfeiture provision. The TTC appealed.

4 The trial judge awarded Gottardo and CGU only 50% of their costs on the basis that it was Gottardo's error that ultimately caused the litigation. The defendants have sought leave to cross-appeal on the costs issue.

5 On appeal, CGU conceded that the trial judge erred in her interpretation of the bid bond and agreed that if Contract A had come into existence between Gottardo and the TTC and provided that rescission of the contract was not ordered, then the TTC could recover on the bid bond for a breach by Gottardo.

6 The issues on appeal are, therefore, as follows: (1) whether Contract A was entered into when the tenders were opened; (2) whether Gottardo's error was apparent on the face of the tender documents so as to prevent the formation or enforcement of Contract A; and (3) whether equitable rescission was available to Gottardo on the facts of this case.

The Law

7 The leading authority in the area of tenders is the Supreme Court of Canada's decision in *R. v. Ron Engineering & Construction (Eastern) Ltd.*, [1981] 1 S.C.R. 111 (S.C.C.). In that case, the court stated that it was important that integrity in the bidding system be protected to the extent possible under the law of contract and determined that a unilateral contract, referred to as Contract A, arose automatically upon the submission of the tender. The contract was between the contractor who submitted the tender and the owner. The tenderer could not withdraw the tender for a specific period of time as provided in the instructions to tenderers. If the tender was accepted within that specified period of time, the parties would enter into a construction contract, referred to as "Contract B". If the tender was not accepted within that period of time, the tenderer could recover any deposit or tender bond that had accompanied the tender. If, after Contract A was formed, the tenderer alleged that it had made a mistake in the bid, the court would look for evidence of the mistake on the face of the tender documents and the circumstances in existence at the moment when the tenders were opened and Contract A was formed and not at a later date.

8 *Ron Engineering* was considered by the Supreme Court of Canada in its later decision of *M.J.B. Enterprises Ltd. v. Defence Construction (1951) Ltd.*, [1999] 1 S.C.R. 619 (S.C.C.). In that decision, the court made it clear that Contract A also imposed obligations on the owner. It explained that Contract A did not come into existence in all tender situations, nor was a tender always irrevocable as a term of the tender contract. In all cases, the court had to look at the terms and conditions of the tender call. The court stated at para. 19 that what matters is "whether the parties intend to initiate contractual relations by the submission of a bid. If such a contract arises, its terms are governed by the terms and conditions of the tender call".

9 The Supreme Court of Canada addressed the issue again in *Martel Building Ltd. v. R.*, [2000] 2 S.C.R. 860 (S.C.C.). After quoting the above-mentioned passage from *M.J.B. Enterprises Ltd.*, it stated that the tender instructions are critical in any analysis of the contractual relations between the parties. If Contract A is formed, the tenderer is taken to have agreed to comply with all of the requirements set out in the tender documents.

Position of the Parties

10 The appellant submits that the trial judge erred in not finding that Contract A came into existence when the sealed tenders were opened. The trial judge further erred in using a cost breakdown provided by Gottardo after the tenders were opened to find that Gottardo's error was apparent on the face of the tender documents and that this entitled Gottardo to withdraw the tender.

11 The respondents submit that the trial judge was correct in her decision. The tender process put in place by the TTC consisted of two phases. The first phase was the opening of the tenders. The second phase was the provision of additional information required pursuant to the tender instructions. Contract A would not come into existence until after the second phase was complete. In compliance with its obligation to provide the phase two documents, Gottardo sent the TTC a cost breakdown. This cost breakdown clearly showed that the original tender price was a mistake. As a result, the TTC knew of Gottardo's mistake before Contract A was entered into and the TTC could not, therefore, require Gottardo to honour its tendered price. In the alternative, the respondents say that rescission ought to be ordered on the facts of this case.

Analysis

i) Trial Judge's reasons

12 The trial judge determined that because the tender instructions provided that the TTC could demand the production of certain documents after the opening of the tenders, Contract A would not be formed until sometime after these additional documents were demanded and provided. The reasons, however, do not address the critical issue as set out by the Supreme Court of Canada in *M.J.B. Enterprises Ltd.*: when did the parties in fact intend to initiate contractual relations? Rather, the trial judge appears to have confused the creation of Contract A and the process of analysis that leads to the acceptance of the tender and the formation of Contract B. This confusion is apparent from the following two passages from her reasons:

> Once the Tender was submitted, further steps were envisaged: a demand for clause 7.2 documents to be provided within two business days, a response by the tenderer to that demand, then tender evaluation pursuant to clause 8 and clause 11, and then acceptance or rejection of a bid. All of that is part of the first phase. [1]
>
> . . . . .
>
> Based on the documents provided by the TTC, I find that Contract A could only be created when the following steps had occurred: TTC issues the Instructions to Tenderers; in response, a contractor makes a bid; TTC demands the clause 7.2 documents and information; the contractor responds to the demand; TTC conducts the evaluation and acceptance pursuant to clause 8 along with clause 11 [2] [emphasis added].

13 Acceptance or rejection of the bid is not what leads to the creation of Contract A. Acceptance or rejection is the end point of the tender process. Once the tender is accepted, the parties enter into the construction contract referred to as Contract B. The fact that certain steps are taken and certain documents are to be produced by the tenderer after the submission and opening of tenders will not delay the formation of Contract A when the clear intent of the parties is to be bound as of the opening of the tenders.

ii) When was Contract A formed?

14 When the parties intend to initiate contractual relations is determined by analyzing the tender instructions and the other evidence presented at trial. From this analysis, the court can establish whether there was an intention to initiate contractual relations by the submission of a bid and thereby determine if and when Contract A was formed.

15 The tender instructions set out in considerable detail the process which was to be followed. Pursuant to those instructions, each tenderer submitted a signed form of tender in a sealed envelope by 2:00 p.m. on December 20, 2000. Some fifteen minutes later the tenders were opened in public and at that moment it was revealed that Gottardo's tender was the lowest.

16 Paragraph 7.1 of the tender instructions listed the documents that were to be submitted together with the form of tender. Paragraph 7.2 of the tender instructions stipulated that the tenderers had to furnish additional listed documents upon the TTC's request.

17 The tender instruction stipulated that:

> (a) after the tender closing date of December 20 at 2:00 p.m., the tender could not be withdrawn until expiration of the tender validity period of 120 days;
>
> (b) the 120 day period was to allow the TTC to evaluate the various tenders;
>
> (c) the form of tender submitted by the tenderer had to be accompanied by a bid bond or other specified form of security deposit.

18 One critical document was the form of tender, which Gottardo signed and submitted in a sealed envelope. It set out that Gottardo:

> (a) had read the tender documents (which included the tender instructions) and accepted the terms;
>
> (b) was tendering and offering to do the work for the tender price of $4,811,00.00;
>
> (c) agreed to comply with all the terms and conditions set out in the tender documents;
>
> (d) had attached all of the documents that the tender instructions said must accompany the form of tender;
>
> (e) agreed to provide additional documents listed in paragraph 7.2 within forty-eight hours of a request by the TTC; and
>
> (f) agreed that "this Tender is valid for acceptance for a period of one hundred and twenty (120) calendar days from the date of closing of Tenders and that the [TTC] may at any time within the said period accept this Tender whether or not any other Tender has been previously accepted." [3]

19 It is clear from these documents that the parties intended to initiate contractual relations the moment that the tenders were opened. The tender was capable of acceptance by the TTC at any time from that point forward for a period of 120 days and could not be withdrawn by Gottardo. The TTC, for its part, was bound to award the contract in accordance with the tender provisions. Gottardo's tender amounted, in law, to an acceptance of the call for tenders and gave rise to Contract A.

20 Before awarding the contract and entering into Contract B, the TTC could analyze and review the various tenders and could, pursuant to the tender instructions, request and review additional background documentation. Although the analysis to be undertaken by the TTC as contemplated by the tender instructions made this case factually different from *Ron Engineering*, these differences did not, as the trial judge suggested, delay the creation of Contract A. They would only delay the formation of Contract A if, taken together with all the other facts and circumstances, they reflected an intention by the parties to defer the creation of contractual relations.

21 On the facts of this case, it is clear that Gottardo understood the tender process and the fact that contractual relations had been created by its signature and submission of the form of tender on December 20. The documentation is quite clear and Gottardo was familiar with tenders and the tendering process. Gottardo's understanding is also reflected by the statement contained in its letter sent to the TTC upon discovery of the error in the tender price. In that letter, Gottardo asked the TTC: "Please take no action against our bid bond". This indicates an understanding that a contractual relationship had been entered into.

iii) Was there an error on the face of the tender to prevent the formation or enforcement of Contract A?

22 The respondents argued that even if Contract A was formed on the opening of the tenders and that no error was apparent from the Form of Tender submitted, the contract was nonetheless unenforceable as a result of Gottardo's response to the TTC's later request for documents pursuant to para. 7.2. The para. 7.2 documents consisted of various lists, including a list of contracts presently underway, a list of users for whom the tenderer had executed works of a similar order or nature, as well as a cost summary which would serve as a basis for working out progress payments.

23 Shortly after the tenders were opened, the TTC requested the documents listed in para. 7.2. Gottardo did not provide any of the documents requested with the exception of the cost summary. According to Gottardo, two things flowed from this:

> (a) since Gottardo did not provide any of the para. 7.2 documents other than the cost summary, it was not in compliance with the tender instructions and, as a result, Gottardo's bid became non-compliant after Contract A was formed. Once the bid became non-compliant, it could no longer be accepted by the TTC; and
>
> (b) the cost breakdown provided by Gottardo to the TTC in response to the para. 7.2 request showed a different total tender price from the one contained in the form of tender. Since this additional document was provided pursuant to the tender instructions and at the TTC's request, the error, which was not apparent at the point when the tenders were opened, became apparent on the face of the subsequently produced para. 7.2 documents.

24 I will deal with each of these submissions in turn.

a) Failure to provide the additional documentation

25 The instructions to tenderers contemplated that once the tenders had been submitted and opened, the TTC could require the tenderers to provide additional documentation to be used in its evaluation process and in the preparation of Contract B. By signing the form of tender, the tenderers specifically agreed to provide the documents should these be requested by the TTC as provided in the instructions to tenderers.

26 Once the para. 7.2 documents were requested from a compliant tenderer, the failure to provide these documents was a breach of Contract A, and could not change the status of the bid and render it non-compliant. The breach by the tenderer of Contract A, whether at an early stage in refusing to produce required documentation or at a later stage in refusing to sign Contract B, does not make the bid non-compliant. It would defeat the integrity of the bidding system to allow a bidder who has complied with all the tender requirements in the submission of its tender to thereafter breach its obligations pursuant to Contract A and then treat this breach as freeing it from its commitment.

b) The error disclosed by the cost summary

27 It is clear that the cost summary provided by Gottardo indicated a different total tender price from that contained in the form of tender submitted on December 20. This document, however, was provided after Contract A was formed and the manner in which it was completed did not comply with the tender instructions. Although the tender instructions required the tenderer, on request, to submit a cost summary, the instructions also clearly stipulated that the cost summary "shall aggregate the total tendered price for the contract". A non-compliant document cannot, in my view, be used by Gottardo to show an error on the face of the tender.

28 Having concluded that Contract A was formed when the tenders were opened and that there was no error apparent on the face of the tender, the facts, as determined by the trial judge establish that Gottardo was in breach of the contract and that the damages flowing from this breach totalled $434,000.00.

iv) Was rescission available to Gottardo on the facts of this case?

29 The trial judge said, in *obiter*, that if she had found that Contract A had been formed, she would then have granted rescission in light of the financial hardship that this mistake would cause to Gottardo.

30 It is well established that rescission may only be granted in cases of unilateral mistake when the unmistaken party engaged in fraud or some other unconscionable conduct or where the unmistaken party contributed to the mistake. As set out in G.H.L Friedman, *The Law of Contract in Canada*, 4th ed. (Toronto: Carswell, 1999), at 273-274:

> As long as the unmistaken party knows of the mistake, without having caused it, the party cannot resist a suit for rectification on the grounds of mistake. The same will apply if the other party had good reason to know of the mistake and to know what was intended. The converse of the proposition as to knowledge of the other party's mistake is that if the unmistaken party is ignorant of the other's mistake, the contract will be valid and neither rescission nor rectification will be possible.

31 In the case of tenders, the rights of the parties crystallize and Contract A is formed upon the opening of the tenders. Nothing on the face of the documents then in existence, including the form of tender, suggested that the tender amount was in error. At that point in time no one was aware of an error and the tender was compliant and capable of acceptance.

32 The trial judge's reasons make it clear that the mistake was unilateral and that there was no fraud. The trial judge, however, found that since the mistake was honestly made and inadvertent and because enforcement would cause Gottardo financial hardship, she would grant rescission. With respect, I do not agree. In my view, there are no unique circumstances in this case which distinguish it from *Ron Engineering* and which would operate so as to entitle the tenderer to have the contract rescinded. While it is conceded that some financial hardship will flow from enforcement of the contract, this is not sufficient to warrant rescission. The burden imposed on Gottardo by the enforcement of the contract freely entered into is not so grossly disproportionate so as to make enforcement of it by the courts unconscionable. In the circumstances, there are simply no grounds for equitable intervention.

33 In the result, I would allow the appeal, set aside the decision of the trial judge and issue judgment in favour of the appellant in the amount of $434,000 against both defendants together with pre and post judgment interest. I would also award the TTC costs of the trial on the partial indemnity scale in an amount to be agreed upon by the parties or as assessed.

34 In light of the disposition of the appeal that I propose, I need not deal with the cross-appeal on costs.

35 The TTC's draft bill of costs for the appeal claims $82,109.80, which is roughly twice as much as either of the respondent's draft bills of costs and roughly twice as much as either respondent was awarded in trial costs. In my view, the amount sought by the appellant is, in the context of this case, too high. I would award costs of the appeal to the TTC on the partial indemnity scale and fix them at $35,000 inclusive of GST and disbursements.

Borins J.A.:

I agree.

Feldman J.A.:

I agree.

Appeal allowed.

Footnotes

1 The trial judge's reasons paragraph 31.

2 The trial judge's reasons paragraph 34.

3 Form of Tender, page 4, Appeal Book and Compendium II, tab 38.

End of Document

TAB 15

1968 CarswellOnt 232
Ontario Court of Appeal

Mundinger v. Mundinger

1968 CarswellOnt 232, [1968] O.J. No. 1339, [1969] 1 O.R. 606, 3 D.L.R. (3d) 338

Mundinger v. Mundinger

Schroeder, Kelly and Laskin, JJ.A.

Judgment: December 12, 1968

Proceedings: Reversed, (September 5, 1967), Doc. (Ont. S.C.); Affirmed, 14 D.L.R. (3d) 256 (note), [1970] S.C.R. vi (S.C.C.)

Counsel: *G. B. Bagwell, Q.C.*, for appellant.
W. D. O'Malley, Q.C., for respondent.

Subject: Family; Contracts

Headnote

Family Law --- Domestic contracts and settlements — Attacking validity of contract — Duress, fraud, unconscionability

Wife entering into improvident separation agreement under influence of alcohol, drugs — Whether onus of upholding transaction discharged.

The trial judge dismissed a wife's action for alimony and refused to make an order declaring that a separation agreement was null and void on the grounds that it had been procured by fraud, threats and undue influence. An order setting aside two conveyances was also refused. Wife alleged that her husband's cruelty and adultery had caused her to have a nervous breakdown and that she had been hospitalized after taking an overdose of tranquillizers. Husband demanded a separation and asked her to execute an agreement prepared by his solicitor which provided that in return for a consideration of $5,000 she would give up the right to maintenance and convey to him, her one-half interest in real property worth about $60,000. Wife obtained legal advice and when her husband learned of her counter-offer he adopted a threatening attitude towards her. She finally signed an agreement which provided for the payment of $10,000. The trial judge accepted the evidence of an intern that the wife had been mentally capable of entering into these transactions and disregarded that of her family doctor and psychiatrist. Wife appealed. Held, the appeal was allowed. The transactions were unconscionable and improvident on their very face. Wife had surrendered her interest in valuable real estate and rights of support for a paltry sum when under the influence of tranquillizers and brandy, the latter provided by husband. The equitable rule was that if a donor were not a free agent and was not equal to protecting himself, the Court would protect him, not against his own folly or carelessness, but against his being taken advantage of by those in a position to do so. In such cases the onus was placed on the party seeking to uphold the transaction and in the instant case husband had failed to discharge that onus.

The judgment of the Court was delivered orally by *Schroeder, J.A.*:

1 This is an appeal from a judgment pronounced by Hartt, J, on September 5, 1967, whereby he dismissed the plaintiff's action against her husband for alimony; for an order declaring that a certain separation agreement entered into between

the parties on June 9, 1965, was null and void and should be set aside on the ground that the plaintiff was induced to execute it through the husband's fraud and threats and by reason of duress and undue influence, at a time when, to his knowledge, she was suffering from a serious nervous breakdown and was not in a mentally competent condition to appreciate the nature and quality of her act; and further dismissing the plaintiff's claim for an order declaring null and void a certain conveyance by the wife to the husband of property known and described for municipal purposes as 23 Oriole Gardens in the City of Toronto, and a conveyance by the wife to the husband of her interest in a 50-acre parcel of land in the Township of Uxbridge in the County of Ontario both of which properties had been registered in the names of the spouses as joint tenants.

2 The parties were married on April 5, 1939, and resided throughout their married life in the City of Toronto. There were three children of the marriage who are now of age and married. The wife complained of many acts of cruelty on the part of the husband during their married life and more particularly of his conduct to her towards the end of the period of cohabitation. Her principal complaint was as to an intimate and adulterous relationship between the husband and one Doris Johnson, which he stubbornly continued notwithstanding his wife's emphatic objections. She alleged that her husband's maltreatment had caused her to have a nervous breakdown. She became so depressed in this unhappy state of affairs that while under the care of her family physician who was administering tranquillizers to her she took an overdose of those drugs and became so dangerously ill that she was confined to the hospital on April 26, 1965, where she remained until May 14, 1968.

3 During her confinement in the hospital the husband demanded a separation. This ill-timed and inconsiderate request was a severe shock to the appellant which aggravated the condition of tension and anxiety under which she was then labouring. Shortly after her return from the hospital the husband presented and asked her to sign a separation agreement which had been prepared by his solicitor, which provided, *inter alia*, that in consideration of $5,000 she was to relinquish all rights to support and maintenance, was to convey to her husband her undivided one-half interest in the Oriole Gardens property the equity value of which was said to be $20,000, and to convey her one-half interest in the farm property near Uxbridge, which was said to have a value of approximately $40,000. Although she was advised by the respondent that she did not require a solicitor she heeded the advice of a friend and consulted Mr. Bowden McLean, a solicitor, who wrote a letter dated June 1, 1965, to Messrs. Rowland & Givertz, the respondent's solicitors, expressing his client's dissatisfaction with the agreement and stating the terms which would be acceptable to her.

4 When the husband was apprised of the terms so proposed he flew into a violent rage and a quarrel ensued, in the course of which he addressed his wife in an abominable manner and adopted a very threatening attitude towards her. He stated that he had a solicitor who could look after their affairs and it was not necessary that she be separately advised. On or about June 9, 1965, the defendant redrafted the agreement as previously prepared by his solicitors in the same terms but substituting for the sum of $5,000 to be paid to the wife, the sum of $10,000. In the result the appellant was induced to telephone Mr. McLean, to advise him that she had settled her affairs with her husband and that he should submit his account for services rendered.

5 The defendant is the president of the Mundinger Company Limited and related enterprises which engages in the merchandising of musical instruments and provides musical instruction. For many years following the marriage the wife took an active part in the business as an officer and employee of the company and more especially in the teaching activity. In 1952 or 1953 the said Doris Johnson entered the service of the company and almost immediately thereafter replaced the wife not only in the conduct of the company's affairs but apparently, also, in the husband's affections. The learned Judge found that the continued association between the defendant and Mrs. Johnson on a personal basis "was such that the defendant well knew that it was injurious to the health of the plaintiff". "On this ground alone", he stated, "I would have found that the plaintiff, Mrs. Mundinger, was entitled to alimony." He held, however, that the separation agreement signed by the wife was a bar to her cause of action. He stated:

> I have given to the evidence prolonged and anxious consideration, and I have come to the conclusion that on the evidence before me, and having in mind the onus of proof that a case had not been made out.

He found on the evidence of one Jack Souter and Dr. Caroline Hobbs, a resident intern at St. Michael's Hospital, that the wife was mentally capable of entering into these transactions, disregarding almost entirely the evidence of her family physician who had treated her for many years and of Dr. Fischer, an eminent psychiatrist under whose care she had been for several years prior to the dates with which we are concerned. Both of these medical witnesses, who were familiar with the unhappy situation in which this unfortunate plaintiff was involved, testified that, in their opinion, she was not in a mental condition to exercise proper judgment in matters affecting her property rights and temporal welfare. The evidence of the witnesses Souter and Givertz, the solicitor, was based on their observation of the appellant during the short period when she executed the separation agreement and deeds respectively. The young resident intern formed no settled opinion as to the mental capacity of the appellant to transact business of such a nature and, in any event, her testimony upon this point was quite inconclusive. There was no proper ground for preferring it to the evidence of her general physician and Dr. Fischer.

6 With deference to the learned Judge's view we are all of the opinion that he arrived at his decision in this case under the belief that despite the circumstances disclosed in evidence the onus of proof lay throughout on the plaintiff. The transactions in question are unconscionable and improvident on their very face as the learned Judge suggested. The plaintiff, now 52 years of age, has devoted the most important years of her life to her husband and their three children. She was influenced by her husband when suffering from the effects of a serious nervous breakdown, while under the influence of tranquillizers and other forms of sedation prescribed for her condition and doubtless also while affected by brandy which was liberally provided by the husband for reasons best known to himself, to surrender all rights to future support and maintenance and to part with a valuable interest in two pieces of real estate for the paltry consideration of $10,000. Her condition was such that it can clearly be asserted that her husband was in a position of dominance and control over her of which he took full advantage by exercising undue influence upon her to carry off this improvident and nefarious transaction.

7 The governing principle applicable here was laid down by this Court in the oft-cited cases of *Vanzant v. Coates* (1917) 40 O.L.R. 556, 39 D.L.R. 485 (C.A.). It was there held that the equitable rule is that if the donor is in a situation in which he is not a free agent and is not equal to protecting himself, a Court of Equity will protect him, not against his own folly or carelessness, but against his being taken advantage of by those in a position to do so because of their position. In that case the circumstances were the advanced age of the donor, her infirmity, her dependence on the donee; the position of influence occupied by the donee, her acts in procuring the drawing and execution of the deed; and the consequent complete change of a well-understood and defined purpose in reference to the disposition of the donor's property. It was held that in those circumstances the onus was on the plaintiff to prove by satisfactory evidence that the gift was a voluntary and deliberate act by a person mentally competent to know, and who did know, the nature and effect of the deed, and that it was not the result of undue influence. That onus had not been discharged; and it was therefore held to be unnecessary for the defendant to prove affirmatively that the influence possessed by the plaintiff had been unduly exercised.

8 The principle enunciated in *Vanzant v. Coates, supra*, has been consistently followed and applied by the Courts of this Province and the other common law Provinces of Canada. The effect of the relevant decisions was neatly stated by Professor Bradley E. Crawford in a commentary written by him and appearing in 44 Can. Bar Rev. 142 (1966) at p. 143, from which I quote the following extract:

> If the bargain is fair the fact that the parties were not equally vigilant of their interest is immaterial. Likewise if one was not preyed upon by the other, an improvident or even grossly inadequate consideration is no ground upon which to set aside a contract freely entered into. It is the combination of inequality and improvidence which alone may invoke this jurisdiction. Then the onus is placed upon the party seeking to uphold the contract to show that his conduct throughout was scrupulously considerate of the other's interests.

This correctly sets forth the effect of the decisions bearing upon this and like problems and I adopt it as an accurate statement of the law. On the evidence in the present case there was that combination of inequality and improvidence

which justifies the Court in saying that the defendant has failed to discharge the onus which, in the circumstances, was cast upon him.

9 The appeal is allowed with costs. The separation agreement shall be declared null and void and set aside. The deed of the farm property shall likewise be declared null and void and be set aside. There shall be a declaration that the wife is entitled to alimony for a sum to be determined on a reference to the Master for that purpose which shall be payable from the date of the commencement of the action. There shall also be a reference to the Master with respect to the residential property at Oriole Gardens which has been sold by the defendant and to fix the proportion of the proceeds thereof payable to the appellant. Counsel stated that since the conveyance of the farm property to the husband he has expended certain monies in the making of improvements thereto. On the reference to the Master there shall also be an inquiry as to the extent of these improvements and their value, the wife to be allowed occupation rent for the period during which she was excluded from enjoyment of the property. The sum of $10,000 paid by the husband to the wife will, of course, be taken into account by the Master in determining what is due to the appellant. The appellant shall have the costs of the trial, the costs of the appeal and the costs of the reference on a solicitor-and-client basis.

Appeal allowed

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TAB 16

1999 CarswellOnt 3171
Supreme Court of Canada

Guarantee Co. of North America v. Gordon Capital Corp.

1999 CarswellOnt 3171, 1999 CarswellOnt 3172, [1999] 3 S.C.R. 423, [1999] S.C.J. No. 60, [2000] I.L.R. I-3741, 126 O.A.C. 1, 15 C.C.L.I. (3d) 1, 178 D.L.R. (4th) 1, 247 N.R. 97, 39 C.P.C. (4th) 100, 49 B.L.R. (2d) 68, 91 A.C.W.S. (3d) 796

Guarantee Company of North America, Appellant v. Gordon Capital Corporation, Respondent and Chubb Insurance Company of Canada and Laurentian General Insurance Company Inc., Respondents

L'Heureux-Dubé, Gonthier, Iacobucci, Major, Bastarache JJ.

Heard: June 17, 1999
Judgment: October 15, 1999
Docket: 26654

Proceedings: reversing (1998), 157 D.L.R. (4th) 643 (Ont. C.A.); reversing (1997), 32 O.R. (3d) 428 (Ont. Gen. Div.)

Counsel: *Kenneth W. Scott, Q.C.*, *James D. Patterson* and *Sharon C. Vogel*, for appellant.
Thomas G. Heintzman, Q.C., *R. Paul Steep* and *Darryl A. Cruz*, for respondent, Gordon Capital Corporation.
Jamieson Halfnight, *Glynis Evans* and *Ian H. Fraser*, for respondents, Chubb Insurance Company of Canada and Laurentian General Insurance Company Inc.

Subject: Insolvency; Civil Practice and Procedure; Contracts; Insurance

Headnote
Bankruptcy

Limitation of actions --- Actions in contract or debt — Actions on insurance policies — When time begins to run

Investment dealer brought action against insurer for payment under fidelity insurance contract — Insurer brought successful motion for summary judgment dismissing action — Motions judge held that action was not brought within 24 months of discovery of loss, as required by insurance contract — Appeal by dealer allowed — Court of appeal held that where insurer repudiates contract, insured is excused from affirmative future obligations contained within contract, including limitation period — Appeal by insurer allowed — Motions judge did not err in determining that case was proper one for summary judgment — No policy reason exists to limit construction approach to fundamental breach to exclusion clauses alone — Under construction approach, limitation period in insurance contract survived wrongful rescission of contract — Intention of parties was that limitation clause was to include process of bringing a claim against insurer in circumstances of contractual breach — It would not be unconscionable, unfair, unreasonable or otherwise contrary to public policy to uphold intention of parties.

Insurance --- Actions on policies — Practice and procedure — Miscellaneous issues

Investment dealer brought action against insurer for payment under fidelity insurance contract — Insurer brought successful motion for summary judgment dismissing action — Motions judge held that action was not brought within 24 months of discovery of loss, as required by insurance contract — Appeal by dealer allowed — Court of appeal held that where insurer repudiates contract, insured is excused from affirmative future obligations contained within contract, including limitation period — Appeal by insurer allowed — Motions judge did not err

in determining that case was proper one for summary judgment — No policy reason exists to limit construction approach to fundamental breach to exclusion clauses alone — Under construction approach, limitation period in insurance contract survived wrongful rescission of contract — Intention of parties was that limitation clause was to include process of bringing a claim against insurer in circumstances of contractual breach — It would not be unconscionable, unfair, unreasonable or otherwise contrary to public policy to uphold intention of parties.

Prescription des actions --- Action en matière de contrat ou de créance — Actions relatives à des polices d'assurance — Quand le délai commence à courir

Maison de courtage de valeurs mobilières a intenté une action en paiement contre l'assureur, en vertu d'une police d'assurance contre les détournements — Compagnie d'assurance a présenté une motion visant à obtenir un jugement sommaire rejetant l'action et elle a obtenu gain de cause — Juge des requêtes a conclu que l'action n'avait pas été intentée dans les 24 mois suivant la découverte du sinistre, tel qu'exigé par le contrat d'assurance — Pourvoi formé par la maison de courtage a été accueilli — Cour d'appel a jugé que lorsque le contrat a été résilié par l'assureur, l'assuré est libéré de ses obligations futures, incluant le délai de prescription — Pourvoi formé par l'assureur a été accueilli — Juge des requêtes n'a pas commis d'erreur en jugeant que le dossier était suffisant pour rendre un jugement sommaire — Aucune raison de principe de restreindre aux seules clauses d'exclusion la façon d'aborder l'inexécution fondamentale sous l'angle de l'interprétation — Selon la méthode d'interprétation, les délais de prescription contractuels survivent à la résiliation injustifiée du contrat — Intention des parties était d'inclure un processus de réclamation contre l'assureur en cas de rupture du contrat — Il ne serait pas inique, injuste, déraisonnable ou par ailleurs contraire à l'ordre public de respecter l'intention des parties concernant l'application du délai de prescription contractuel.

Assurance --- Actions relatives à des polices — Pratique et procédure — Questions diverses

Maison de courtage de valeurs mobilières a intenté une action en paiement contre l'assureur, en vertu d'une police d'assurance contre les détournements — Compagnie d'assurance a présenté une motion visant à obtenir un jugement sommaire rejetant l'action et elle a obtenu gain de cause — Juge des requêtes a conclu que l'action n'avait pas été intentée dans les 24 mois suivant la découverte du sinistre, tel qu'exigé par le contrat d'assurance — Pourvoi formé par la maison de courtage a été accueilli — Cour d'appel a jugé que lorsque le contrat a été résilié par l'assureur, l'assuré est libéré de ses obligations futures, incluant le délai de prescription — Pourvoi formé par l'assureur a été accueilli — Juge des requêtes n'a pas commis d'erreur en jugeant que le dossier était suffisant pour rendre un jugement sommaire — Aucune raison de principe de restreindre aux seules clauses d'exclusion la façon d'aborder l'inexécution fondamentale sous l'angle de l'interprétation — Selon la méthode d'interprétation, les délais de prescription contractuels survivent à la résiliation injustifiée du contrat — Intention des parties était d'inclure un processus de réclamation contre l'assureur en cas de rupture du contrat — Il ne serait pas inique, injuste, déraisonnable ou par ailleurs contraire à l'ordre public de respecter l'intention des parties concernant l'application du délai de prescription contractuel.

An investment dealer entered into a fidelity insurance contract with its insurer, which covered dishonest and fraudulent acts committed by the dealer's employees. The dishonest borrowings of an employee led to a loss to the dealer of approximately $90,000. The dealer submitted a proof of loss to the insurer. The insurer repudiated the insurance contract, stating that the dealer had made a material misrepresentation in its application for the insurance contract. In its application, the dealer had indicated that customer accounts would be reviewed on a monthly basis by a partner, officer or other designated employee not involved with the relevant account. The proof of loss filed by the dealer indicated that the accounts which led to the loss were under the sole responsibility of the dishonest employee and were not subject to review. The dealer denied the validity of the rescission, and brought an action against the insurer. The insurer brought a successful motion for summary judgment dismissing the action. The motions judge held that the action was not brought within 24 months of the discovery of the loss, as required by the insurance contract. The motions judge held that even if the rescission was wrongful, it did not prevent the insurer from relying on the limitation provision in the contract. The dealer brought an appeal, claiming that the insurer

was not entitled to rely on the limitation period contained within the insuring contract after having repudiated the contract. The appeal was allowed. The court of appeal held that where an insurer repudiates a contract, the insured is excused from affirmative future obligations contained within the contract, including limitation periods. The insurer brought an appeal.

Held: The appeal was allowed.

All that was required under the insurance contract for discovery of loss were sufficient facts to cause a reasonable person to assume that a loss of a type covered by the contract would be incurred. The loss did not have to be conclusively determined to be covered in order for discovery to occur. The motions judge did not err in determining that the case was a proper one for summary judgment. The motions judge inferred that it could reasonably be assumed that a loss of the type covered by the contract had occurred in July 1991, as the dealer knew that its employee had acted fraudulently and the dealer had already incurred interest charges in respect of a $90,000 loan to meet its regulatory capital obligations. The undisputed facts in the case strongly supported this inference. The dealer's filing of a notice of loss was a strong indication that the dealer reasonably assumed that a loss covered by the contract had been or would be incurred. The motions judge's conclusion that the affidavits filed on the motion did not raise a credibility issue sufficient to require a trial was not unreasonable, particularly since the true test of discoverability is an objective one. On a proper reading of the contract, a loss of the type covered was simply a loss resulting from employee dishonesty with the presumption that the manifest intent of such behaviour was personal gain. The relevant provision in the contract excluded the requirement of actual loss and thus defeated the dealer's argument that loss must be incurred for the limitation period to commence. There was no legal issue to be resolved at trial.

For the purposes of the summary judgment motion, the insurer agreed to proceed on the basis that its rescission of the contract was wrongful. The issue, therefore, was whether the wrongful rescission precluded the insurer from relying on the contractual limitation period. There is no principled distinction between clauses excluding liability and those setting out the applicable limitation periods. The courts should respect the bargain made by the parties in both cases. There is no policy reason to limit the construction approach to fundamental breach to exclusion clauses alone. Under the construction approach, the limitation period in the contract survived the wrongful rescission of the contract. Commercial reality was the best indicator of the contractual intention of the parties. If the time limitation clause could not be invoked by the insurer, once the insurer had taken steps to enforce the contractual provision permitting rescission on the basis of a purported misrepresentation by the dealer, it would lead to an absurd result. The insurer would be placed in the untenable position of subjecting itself to a longer statutory limitation period than would otherwise apply in circumstances where coverage had been denied for other reasons. Commercial reality could not accommodate the implication that the insurer agreed to a bargain whereby it would be exposed to a longer period of uncertainty concerning future claims from an insured who has purportedly engaged in misrepresentation than one who has complied with all of the contractual terms. The intention of the parties was that the limitation clause was to include the process of bringing a claim against the insurer in circumstances of contractual breach, whether fundamental or otherwise. The parties were sophisticated commercial actors, and were both represented by counsel. It would not be unconscionable, unfair, unreasonable or otherwise contrary to public policy to uphold the intentions of the parties concerning the operation of the contractual limitation period.

Une maison de courtage en valeurs mobilières avait conclu, avec son assureur, un contrat d'assurance qui fournissait une protection contre les actes malhonnêtes ou frauduleux commis par ses employés. Par la suite, elle a subi une perte d'environ 90 000 $ en raison d'emprunts non autorisés effectués par un de ses employés. La maison de courtage a soumis une preuve de sinistre à l'assureur, mais celui-ci a résilié le contrat au motif que la maison de courtage avait fait de fausses déclarations sur des faits importants dans sa demande de police. Dans cette demande, la maison de courtage avait indiqué que les comptes clients feraient l'objet d'une vérification mensuelle par un associé, un dirigeant ou un autre employé désigné n'ayant rien à voir avec le compte concerné. Dans sa preuve de sinistre, la maison de courtage a indiqué que les comptes ayant entraîné la perte relevait uniquement de la responsabilité de l'employé

malhonnête et n'étaient pas sujets à révision. La maison de courtage a contesté la validité de la résiliation de la police et a intenté une action contre l'assureur. Ce dernier a déposé, avec succès, une requête pour jugement sommaire en rejet d'action. Le juge ayant entendu la requête a conclu que l'action n'avait pas été intentée à l'intérieur du délai de 24 mois suivant la connaissance du sinistre, comme le contrat d'assurance le prévoyait. Il a statué que même si la résiliation était injustifiée, cela n'avait pas pour effet d'empêcher l'assureur d'invoquer la disposition relative à la prescription stipulée dans le contrat. La maison de courtage a porté cette décision en appel, arguant que l'assureur ne pouvait être admis à invoquer le délai de prescription prévu dans le contrat d'assurance après avoir résilié le contrat. La Cour d'appel a accueilli l'appel, estimant que lorsqu'un assureur résilie un contrat, l'assuré est libéré de ses obligations futures stipulées au contrat, y compris celles qui concernent les délais de prescription. L'assureur a formé un pourvoi à l'encontre de cette décision.

Arrêt: Le pourvoi a été accueilli.

Tout ce que le contrat d'assurance exigeait en ce qui concernait la découverte d'un sinistre consistait en l'existence de faits suffisants pour amener une personne raisonnable à supposer qu'un sinistre du genre visé par la police pouvait survenir. Il n'était pas nécessaire de décider péremptoirement que le sinistre était visé par la police pour qu'il y ait découverte. Le juge ayant entendu la requête n'a commis aucune erreur en décidant que l'affaire donnait ouverture à un jugement sommaire. Il a conclu que l'on pouvait raisonnablement supposer qu'un sinistre du genre couvert par la police s'était produit en 1991, soit au moment où la maison de courtage avait appris que son employé avait agi frauduleusement et où elle avait dû payer des intérêts sur un prêt de 90 000 $ qu'elle avait contracté pour satisfaire aux obligations réglementaires en matière de capitalisation. En l'espèce, les faits non contestés étayaient fortement cette conclusion. Le dépôt d'un avis de sinistre par la maison de courtage constituait une indication convaincante que cette dernière supposait raisonnablement qu'un sinistre visé par la police était survenu ou surviendrait. La décision du juge ayant entendu la requête selon laquelle les déclarations sous serment produites au soutien de la requête ne soulevaient pas une question de crédibilité nécessitant la tenue d'un procès n'était pas déraisonnable, particulièrement à la lumière du fait que le véritable critère de la possibilité de découvrir est un critère objectif. Selon une juste interprétation de la police, un sinistre du genre visé correspondait simplement au sinistre résultant de la malhonnêteté d'un employé qui avait présumément l'intention manifeste de réaliser un gain personnel. La disposition pertinente de la police excluait la nécessité d'établir un sinistre réel et faisait donc échec à la prétention de la maison de courtage selon laquelle le délai de prescription ne commençait à courir qu'au moment où le sinistre était survenu. Il n'existait aucune question de droit à trancher dans le cadre d'un procès.

Pour que la requête pour jugement sommaire soit entendue, l'assureur a accepté qu'il soit tenu pour pour acquis que sa résiliation du contrat n'était pas fondée en droit. Par conséquent, la question consistait à déterminer si la résiliation injustifiée du contrat par l'assureur avait eu pour effet d'empêcher celui-ci d'invoquer le délai de prescription prévu dans la police. Il n'existe aucun principe établissant une distinction entre les dispositions qui excluent la responsabilité et celles qui fixent un délai de prescription. Dans les deux cas, les tribunaux devraient respecter le contrat intervenu entre les parties. Il n'existe, en principe, aucune raison de restreindre aux seules clauses d'exclusions la façon d'aborder l'inexécution fondamentale sous l'angle de l'interprétation. Suivant cette méthode, le délai de prescription prévu au contrat survit à la résiliation injustifiée. La réalité commerciale constituait le meilleur indicateur de l'intention des parties au contrat. Refuser à l'assureur, après qu'il ait pris les mesures pour rendre exécutoire la clause du contrat permettant la résiliation fondée sur les déclarations apparemment inexactes de la maison de courtage, d'invoquer le délai de prescription entraînerait un résultat absurde. L'assureur se trouverait alors dans la position intenable de s'assujettir lui-même à un délai de prescription légal plus long que celui qui s'appliquerait par ailleurs en cas de refus d'indemnisation pour d'autres motifs. La réalité commerciale était incompatible avec ce qu'impliquait l'argument selon lequel l'assureur aurait accepté par contrat de se voir exposer à une plus longue période d'incertitude en ce qui concerne les réclamations futures d'un assuré qui aurait présumément fait une déclaration inexacte qu'en ce qui concerne celles d'un assuré ayant respecté toutes les modalités du contrat. Les parties voulaient que la clause portant sur la prescription s'applique à l'engagement d'une action

contre l'assureur à la suite d'une inexécution de contrat, que celle-ci soit fondamentale ou autre. Les parties étaient des acteurs commerciaux avisés et étaient toutes deux représentées par des avocats. Il ne serait pas irrationnel, injuste, déraisonnable ou par ailleurs contraire à l'ordre public de respecter l'intention des parties concernant l'application du délai de prescription contractuel.

Table of Authorities

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Abram Steamship Co. v. Westville Shipping Co., [1923] A.C. 773, [1923] All E.R. Rep. 645 (U.K. H.L.) — applied

B.G. Linton Construction Ltd. v. Canadian National Railway (1974), [1975] 2 S.C.R. 678, 49 D.L.R. (3d) 548, 3 N.R. 151, [1975] 3 W.W.R. 97 (S.C.C.) — referred to

Chomedy Aluminium Co. v. Belcourt Construction (Ottawa) Ltd., (sub nom. *Beaufort Realties (1964) Inc. v. Belcourt Construction (Ottawa) Ltd)* [1980] 2 S.C.R. 718, 15 R.P.R. 62, 13 B.L.R. 119, 116 D.L.R. (3d) 193, 33 N.R. 460 (S.C.C.) — referred to

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Confederation Trust Co. v. Alizadeh (February 3, 1998), Doc. 78817/97 (Ont. Gen. Div.) — referred to

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Mills v. S.I.M.U. Mutual Insurance Assn., [1970] N.Z.L.R. 602 (New Zealand C.A.) — distinguished

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Ross v. Scottish Union & National Insurance Co. (1918), 58 S.C.R. 169, 46 D.L.R. 1 (S.C.C.) — referred to

Sail Labrador Ltd. v. Navimar Corp. (1998), (sub nom. *Sail Labrador Ltd. v. "Challenge One" (The))* 169 D.L.R. (4th) 1, 235 N.R. 201, 44 B.L.R. (2d) 1, (sub nom. *Sail Labrador Ltd. v. Challenge One (The))* [1999] 1 S.C.R. 265 (S.C.C.) — referred to

Salmond & Spraggon (Australia) Propriety Ltd. v. Port Jackson Stevedoring Propriety Ltd., [1980] 3 All E.R. 257, [1981] 1 W.L.R. 138, 54 A.L.J.R. 552 (Australia P.C.) — considered

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Statutes considered by/Législation citée par *Iacobucci, Bastarache JJ.*:

Misrepresentation Act, 1967 (U.K.), 1967, c. 7
s. 1 — referred to

APPEAL by insurer from judgment reported at (1998), 157 D.L.R. (4th) 643, 108 O.A.C. 46, [1998] I.L.R. I-3555, 38 O.R. (3d) 563, 3 C.C.L.I. (3d) 202 (Ont. C.A.), allowing dealer's appeal from judgment reported at (1997), 33 B.L.R. (2d) 310, 32 O.R. (3d) 428, 31 O.T.C. 325 (Ont. Gen. Div.), granting insurer's motion for summary judgment dismissing dealer's action.

POURVOI formé par l'assureur à l'encontre de l'arrêt publié à (1998), 157 D.L.R. (4th) 643, 108 O.A.C. 46, [1998] I.L.R. I-3555, 38 O.R. (3d) 563, 3 C.C.L.I. (3d) 202 (C.A. Ont.), accueillant le pourvoi de la maison de courtage contre le jugement publié à (1997), 33 B.L.R. (2d) 310, 32 O.R. (3d) 428, 31 O.T.C. 325 (Div. Gén. Ont.), accueillant la requête de l'assureur demandant un jugement sommaire rejetant l'action de la maison de courtage.

The judgment of the court was delivered by *Iacobucci, Bastarache JJ.*:

1 This appeal deals with the appropriateness of using summary judgment proceedings and with the issue of whether a contractual limitation period survives a wrongful rescission of the contract in dispute. On February 17, 1997, O'Brien J. of the Ontario Court (General Division), sitting as a motions judge, granted summary judgment in favour of the Guarantee Company of North America ("Guarantee"). The judgment declared that Gordon Capital Corporation ("Gordon") had failed to commence legal proceedings for recovery of a loss under Financial Institution Bond No. 401642 (the "Bond") within 24 months from the discovery of "facts which would cause a reasonable person to assume that a loss of a type covered by this bond has been or will be incurred," pursuant to section 3 of the Bond. The Court of Appeal of Ontario set aside the judgment. It determined that Guarantee was precluded from relying on section 3 because it had wrongfully rescinded the said Bond; it also determined that the question of when a loss within the meaning of the Bond was discovered was a triable issue and should be left for determination at trial.

2 There are therefore two issues before this Court. The first is whether the Court of Appeal should have interfered with the motion judge's determination that the record was sufficient to deal with Guarantee's summary judgment motion; the second issue is whether the Court of Appeal erred by finding that the limitation period in the Bond did not survive an affirmation by Guarantee that the Bond was rescinded.

I. Background

3 Gordon is an investment dealer and brokerage firm in Toronto and Montreal. It entered into a $25,000,000 fidelity insurance contract with Guarantee for a term commencing on December 31, 1990 and ending on December 30, 1991. Additional contracts for $10,000,000 of excess insurance each were entered into with Chubb and Laurentian.

4 The Bond provided coverage for "dishonest and fraudulent acts committed by an employee acting alone or in collusion with others," providing the employee acted with the "manifest intent" to obtain financial benefit for himself, other than that which he would earn in the normal course of employment.

5 The insured is required, under section 5 of the Bond, to give to the underwriter notice of loss "at the earliest practicable moment, not to exceed 30 days, after discovery of the loss," and to provide sworn proof of loss within 6 months of the discovery. Legal proceedings for the recovery of "any loss hereunder shall not be brought prior to the expiration of 60 days after the original proof of loss is filed ... or after the expiration of 24 months from the discovery of the loss."

6 The Bond contains a definition of "discovery" in section 3. It reads:

> This bond applies to loss discovered by the Insured during the Bond Period. Discovery occurs when the Insured first becomes aware of facts which would cause a reasonable person to assume that a loss of a type covered by this bond has been or will be incurred, regardless of when the act or acts causing or contributing to such loss occurred, even though the exact amount or details of loss may not then be known.

7 Eric Rachar was a Gordon partner responsible for the Derivative Products Group in Toronto. He engaged in various securities lending and related transactions with Patrick Lett and companies under Lett's control, but led Gordon to believe that those transactions were in effect being carried out with a Designated Financial Institution ("DFI"), specifically National Trust ("National").

8 Between July 16, 1990 and May 22, 1991, Gordon loaned National $1.1 billion in Government of Canada bonds. As collateral for the loans, Gordon received Provincial Government Bonds and bonds from senior financial institutions in equivalent principal amounts with similar maturity dates and cash flow. The trading value of the commodity was inferior but regulatory obligations did not require Gordon to provide additional regulatory capital for a loan to a DFI.

9 Rachar also caused Gordon to enter into transactions with Lett and Citibank involving certificates of deposit, bearer deposit notes, bond forward purchase contracts and securities lending agreements. Because of Rachar's misrepresentations, Gordon accepted worthless collateral which exposed it to high risk.

10 On June 14, 1991, James Connacher, Chairman and Chief Executive Officer of Gordon received a telephone call from Jon Paysant of National, who expressed the concerns of National about "Account # 2," the Rachar-Lett account. On June 17, 1991, a meeting of Gordon and National officers was held to question the unusual features of the transactions. At this meeting, National indicated that it was only acting as agent for Account #2. Gordon conducted a review between June 14 and June 19, 1991 of the collateral held in respect of Account #2. It was determined that the collateral was $51,000,000 less than the value of the Government of Canada bonds.

11 On June 19, Gordon retained the services of a law firm to determine the nature of the National account by looking at the documentation and interviewing Rachar. O'Brien J. found that Gordon relied on the firm to advise them as to the terms of section 5 of the Bond.

12 On June 20, Peter Bailey, the Gordon Compliance Officer, met Rachar, who denied any regulatory or other problem with the Account. On June 21, Bailey and a lawyer from the firm met with Rachar, who admitted knowing of Lett, but affirmed National was acting as principal on the account. On June 24, 1991, Bailey met Rachar again to discuss whether the account was in fact held by an individual rather than a DFI. On June 26, the date at which discovery was made according to the proof of loss filed, Bailey and Rachar met with Lett. Bailey determined Rachar had lied, suspended him and denied him access to Gordon's premises. Gordon notified the Toronto Stock Exchange, who

notified the Ontario Securities Commission, that there had been misrepresentation by Rachar and that it had a margin deficiency. Gordon retained the Forensic Accounting Division of Peat Marwick Thorne and subsequently Lindquist Avey Macdonald Baskerville to conduct an investigation. Bailey advised senior people at Gordon that Gordon would have to put up in excess of $80,000,000 of regulatory capital.

13 On June 27, 1991, Gordon took out a loan of approximately $90,000,000 to meet the regulatory capital obligations. It immediately began paying interest on the loan; this interest was claimed in the sworn proof of loss.

14 On June 28, 1991, Gordon notified Guarantee of a potential fidelity bond claim in relation to the activities of Rachar. During a meeting among representatives of Guarantee, the law firm and Peat Marwick, Brian Clarkin of Guarantee was told that the discovery of the loss by Gordon occurred on June 26, 1991.

15 Bailey testified that he was concerned, on July 1, 1991 "that there had to be some kind of relationship for ... Rachar to proceed with these transactions." He assumed that there had been a relationship between Rachar and Lett. He concluded that Gordon would have to unwind the transactions arising from the dishonest conduct of Rachar and that it would suffer a substantial loss. On July 2, 1991, Guarantee provided Gordon with a proof of loss form. It directed Gordon's attention to the requirements of the Bond.

16 On July 2, 1991, Gordon learned about the irregularities with respect to the Citibank certificates of deposit. It learned of other irregularities on July 5 and July 8, 1991.

17 On July 10, 1991, Rachar agreed to an inspection of his personal records. On August 15, 1991, Gordon was informed that Rachar had obtained a personal benefit in connection with the transactions. In fact, National advised Gordon that it had discovered a cheque payable to Rachar for $800,000 in account of Lett at National.

18 Gordon continued to investigate the activities of Rachar. Lindquist presented a report in February 1992. Gordon then delivered a sworn proof of loss to Guarantee on March 31, 1992, after having obtained two extensions of time for its filing. The report of the forensic investigators was appended to the proof of loss, which affirmed that the date of discovery was June 26, 1991.

19 On August 5, 1992, Guarantee advised Gordon that, pursuant to a provision in the Bond, it was rescinding the Bond, which had in effect expired on December 31, 1991, on the basis that Gordon had made misrepresentations in its application for the bond. In its application for insurance, Gordon represented to Guarantee that for the purposes of internal control, customer accounts would be reviewed on a monthly basis by a partner, officer or other designated employee not involved with the relevant account. The proof of loss submitted by Gordon, however, revealed that Racher had sole responsibility for the National accounts, and that the accounts were not subject to review. After various meetings between the parties, an agreement was reached to allow Guarantee to pursue its investigation. On August 7, 1992, Gordon refused to accept the return of premiums from Guarantee and denied the validity of the rescission. The parties agreed to pursue negotiations without prejudice to their legal positions.

20 On June 30, 1993, Bailey advised Guarantee that Gordon had not commenced an action prior to June 26, 1993. On July 15, 1993, Gordon commenced an action in Quebec, and on July 16 in Ontario. On July 21, 1993, Guarantee set out its position on the limitation period. Guarantee commenced an action in Ontario on July 29, 1993. On August 4, 1993, Gordon filed a notice of intent to defend.

21 On August 20, 1993, Bailey swore an affidavit stating that the monetary benefit which Rachar received was not known on June 26, 1991, "which may result in the date of discovery being after June 26, 1991."

22 Ground J. refused Gordon's motion to stay the Ontario action on January 17, 1994. On April 25, 1994, Montgomery J. refused to grant leave to appeal that decision. This Court refused a further application for leave to appeal. On November 21, 1994, Gordon filed its statement of defence. In January of 1997, Guarantee made a motion for summary

judgment relying only on the limitation period contained in the Bond. Meanwhile, the Quebec Court of Appeal had stayed the Quebec action pending the determination of the Ontario action.

II. Judicial History

(1) The Motion for Summary Judgment (1997), 32 O.R. (3d) 428 (Ont. Gen. Div.)

23 The relevant portion of O'Brien J.'s decision deals with the argument that Guarantee's rescission prevented reliance on the limitation provision, and the argument that the conditions for summary judgment were not met.

24 On the first issue, O'Brien J. held that assuming the rescission was wrongful, it did not prevent reliance on the limitation period contained in the Bond. On the second issue, the motion judge first noted that Gordon had conceded some of the interest expense on money borrowed to meet the margin requirements predated July 16, 1991, and that it constituted "some loss at that time" (at p. 437). He rejected the argument by Gordon that the limitation period did not commence to run until a loss was "incurred" by Gordon. It was his view that there is no ambiguity regarding the word "loss," which must refer to the loss as described in the "Discovery" section of the Bond. This, he said, is not an actual loss.

25 Dealing with the conditions applicable to summary judgment, O'Brien J. said there were no significant issues requiring trial, whether legal or factual. He specifically rejected the argument that the different affidavits of Bailey raised a credibility issue requiring trial.

(2) The Decision of the Court of Appeal (1998), 38 O.R. (3d) 563 (Ont. C.A.)

26 Noting that "this is a very difficult issue and one in which there is little guidance in the jurisprudence of this jurisdiction," Carthy J.A. concluded that the Ontario action was not barred by virtue of the limitation period in the Bond because Guarantee had rescinded the Bond. He reasoned that the limitation period was similar to the filing of a proof of loss provision, and that the latter could not be enforced after rescission on the authority of *Ross v. Scottish Union & National Insurance Co.* (1918), 58 S.C.R. 169 (S.C.C.) at p. 182. In his view, only the neutral features of a contract could survive rescission. On the other issue, Carthy J.A. found that "should this judgment be reversed on further appeal ... the question of when the loss was discovered within the meaning of the bond should be left for determination at trial" (at p. 573). He based his conclusion on the finding that "there are serious factual disputes about when there was discovery of the type of loss covered by the bond" (at p. 573), but gave no indication of the nature of those disputes.

III. Analysis

(1) Were the Conditions for Summary Judgment Met?

27 The appropriate test to be applied on a motion for summary judgment is satisfied when the applicant has shown that there is no genuine issue of material fact requiring trial, and therefore summary judgment is a proper question for consideration by the court. See *Hercules Management Ltd. v. Ernst & Young*, [1997] 2 S.C.R. 165 (S.C.C.) at para. 15; *Dawson v. Rexcraft Storage & Warehouse Inc.* (1998), 164 D.L.R. (4th) 257 (Ont. C.A.) at pp. 267-68; *Irving Ungerman Ltd. v. Galanis* (1991), 4 O.R. (3d) 545 (Ont. C.A.) at pp. 550-51. Once the moving party has made this showing, the respondent must then "establish his claim as being one with a real chance of success." *Hercules, supra*, at para. 15.

28 The limitation period defence raises mixed questions of fact and law. O'Brien J. found that the only disputes were on the application of the law. We find no reason to disturb this finding.

29 Under section 3 of the Bond, all that is required for discovery of loss are sufficient facts to cause a reasonable person to assume that a loss of a type covered by the Bond will be incurred. A loss need not be conclusively determined to be covered in order for discovery to occur. Having accepted that Gordon knew its employee had acted fraudulently before July 16, 1991 and that Gordon had already incurred interest charges in respect of a $90,000,000 loan to meet its regulatory capital obligations, O'Brien J. inferred that it could reasonably be assumed that a loss of the type covered by the policy was or would be incurred. Although O'Brien J. regarded as significant that Gordon had actually incurred

interest charges without questioning whether they were in fact covered by the Bond, he clearly rejected the argument that a loss had to be incurred before the limitation period would commence to run.

30 We are of the view that the undisputed facts in this case lend strong support to the motion judge's inference. Without repeating all that is said in the background section, we would note that Gordon had, on or before June 26, 1991, found out that Account # 2 was not held by a DFI and that Rachar had lied concerning the account; it had borrowed $90,000,000 to meet regulatory capital requirements, hired forensic accountants and instructed its law firm, notified the Toronto Stock Exchange, suspended Rachar and prevented him from entering their premises. Shortly thereafter, Gordon filed a notice of loss and became suspicious of a Rachar-Lett relationship. The filing of a notice of loss in itself is a strong indication that Gordon reasonably assumed that a loss covered by the Bond had been or would be incurred. The fact that the interest paid on account of the loan may eventually not be covered under the Bond is immaterial since a reasonable person would assume it fits within the definition of "a loss of a type covered by the Bond." Likewise, suspicion in itself is not sufficient to constitute discovery, but coupled with all other material facts it would cause a reasonable person to assume a loss has been or will be incurred and a personal benefit is involved.

31 Gordon objected that the various affidavits of Bailey raised a credibility issue sufficient to require a trial. O'Brien J. disagreed. Reading the various affidavits, he was of the view that Bailey's reversal of position after a limitation period defence had been asserted did not create a genuine issue for trial. We agree with that finding. The reversal was based on Bailey's opinion that actual knowledge that Rachar had benefited from his transactions was determinative. The affidavit of November 22, 1995 states that the June 26, 1991 date was used only because this was the date at which Gordon knew it had to meet a capital requirement, not because it believed that a loss of the type covered by the Bond had occurred. O'Brien J. looked at this in the context of the proceedings, taking into account the sophistication of the parties and the fact that they had been discussing their problem with forensic accountants and outside legal counsel. We do not find his conclusion to be unreasonable, especially in view of the fact that the true test of discoverability is an objective one under the terms of section 3 of the Bond. We would add that the trial judge's ruling on this point is entirely consistent with previous decisions holding that a self-serving affidavit is not sufficient in itself to create a triable issue in the absence of detailed facts and supporting evidence. See *Rogers Cable TV Ltd. v. 373041 Ontario Ltd.* (1994), 22 O.R. (3d) 25 (Ont. Gen. Div.); *Confederation Trust Co. v. Alizadeh* (February 3, 1998), Doc. 78817/97 (Ont. Gen. Div.).

32 Gordon insists that the facts known to Gordon did not suffice to cause a reasonable person to assume a loss "of a type" covered by the Bond. O'Brien J. did not discuss this issue except to say that the loss he contemplated was the one described in the "Discovery" section. We believe that on a proper reading of the Bond, a loss of the type covered is simply a loss resulting from employee dishonesty with the presumption that the manifest intent of such behaviour was personal gain. This is the only interpretation that accords with the nature of the fidelity bond and which makes commercial sense. To require evidence of an actual benefit would defeat the purpose of an early notification provision which specifically excludes the need to establish an actual loss. It would also expose the insurer to "long tail" claims (evidence of a personal benefit could come years after evidence of a loss), as argued by the respondent Chubb, and contradict the normal assumption that dishonesty, fraud and deceit are usually associated with personal benefit.

33 Gordon also argues that the question of law is uncertain. In his factum, counsel for Gordon argues that discovery is only established when there is knowledge of a "real loss," or knowledge of all of the facts which the insured must prove in order to entitle him or her to judgment. In fact, the issue is simply one regarding the interpretation of the Bond.

34 Section 3 of the bond first requires that the insured "becomes aware of the facts." This simply means "being informed of" facts. It then provides that those facts "would cause a reasonable person to assume." This is an objective test that does not require a definitive finding, but an assumption. Another component is that those facts relate to a possible loss "of a type covered by the bond." These broad terms refer to the nature of the coverage involved, namely, fidelity insurance. The type of conduct contemplated is dishonest conduct. The section specifies that the loss "has been or will be incurred." This excludes the requirement of actual loss and introduces the notion that the insured may be subject to a loss. The last part of the section specifies the following: "regardless of when the act or acts causing or contributing to such loss

occurred even though the exact amount or details of loss may not then be known"; this is also inconsistent with Gordon's argument that the loss must be incurred. It specifies that the limitation runs from the first evidence establishing discovery.

35 We agree that there is no legal issue to be resolved at trial. The application of the law as stated to the facts is exactly what is contemplated by the summary judgment proceeding. The motion judge found that the undisputed facts met the definition of discovery of loss under the Bond and that a reasonable person would have assumed that they were sufficient to establish that a loss of a type covered by the Bond had been or would be incurred. The Court of Appeal did not provide sufficient reasons on this issue for us to comment. It did not describe the factual disputes in the case, except to say that the interest paid on the loan of $90,000,000 before June 26, 1991 may not have been a covered loss. As mentioned earlier, this last comment is inconsistent with the fact that the Bond does not require that facts known by the insured be ultimately proved to relate to an actual recoverable loss. With regard to the alleged uncertainty of the term "loss," the Court of Appeal agreed with O'Brien J. We are also of the view that no issue for trial has been established in this regard.

36 We would therefore conclude that the motions judge committed no error in determining that this was a proper case for summary judgment. Gordon has not met the evidentiary burden to show there is a genuine issue for trial.

(2) Was Guarantee Precluded from Relying on the Limitations Clause in Section 5(d) of the Bond by Reason of Its Rescission of the Bond?

37 For the purposes of bringing a summary motion, Guarantee agreed to proceed on the basis that its rescission of the Bond was wrongful. Accordingly, the issue to be determined on the motion was the legal question of whether wrongful rescission precluded Guarantee from relying on the contractual limitation period contained in the Bond as a defence to Gordon's claim for coverage.

38 Given both parties' assumption that Guarantee's rescission was wrongful, it is not necessary to address the effect of the contract's limitations period assuming a valid rescission. However, we believe it is worthwhile, both as background and to eliminate some apparent confusion, to address the distinction between rescission and repudiation. This done, we will turn to the question of whether a limitations clause can survive a wrongful rescission.

(a) The Distinction Between Rescission and Repudiation

39 A fundamental confusion seems to exist over the meaning of the terms "rescission" and "repudiation." This confusion is not a new one, as it has plagued common law jurisdictions for years. Rescission is a remedy available to the representee, *inter alia*, when the other party has made a false or misleading representation. A useful definition of rescission comes from Lord Atkinson in *Abram Steamship Co. v. Westville Shipping Co.*, [1923] A.C. 773 (U.K. H.L.) at p. 781:

> Where one party to a contract expresses by word or act in an unequivocal manner that by reason of fraud or essential error of a material kind inducing him to enter into the contract he has resolved to rescind it, and refuses to be bound by it, the expression of his election, if justified by the facts, terminates the contract, puts the parties *in status quo ante* and restores things, as between them, to the position in which they stood before the contract was entered into.

See similarly G. H. L. Fridman, *The Law of Contract in Canada* (3rd ed. 1994), at p. 807.

40 Repudiation, by contrast, occurs "by words or conduct evincing an intention not to be bound by the contract. It was held by the Privy Council in *Clausen v. Canada Timber & Lands Ltd.* ([1923] 4 D.L.R. 751 (British Columbia P.C.)), that such an intention may be evinced by a refusal to perform, even though the party refusing mistakenly thinks that he is exercising a contractual right" (S. M. Waddams, *The Law of Contracts* (4th ed. 1999), at para. 620). Contrary to rescission, which allows the rescinding party to treat the contract as if it were void *ab initio*, the effect of a repudiation depends on the election made by the non-repudiating party. If that party treats the contract as still being in full force and effect, the contract "'remains in being for the future on both sides. Each [party] has a right to sue for damages for *past or future breaches*'" (emphasis in original): *Cheshire, Fifoot & Furmston's Law of Contract* (12th ed. 1991), by M.P. Furmston at p. 541. If, however, the non-repudiating party accepts the repudiation, the contract is terminated, and the

parties are discharged from future obligations. Rights and obligations that have already matured are not extinguished. Furmston, *supra*, at pp. 543-44.

41 So much is relatively clear. Problems have arisen, however, from misuse of the word "rescission" to describe an accepted repudiation. In *Langille v. Keneric Tractor Sales Ltd.*, [1987] 2 S.C.R. 440 (S.C.C.) at p. 455, Wilson J., writing for the Court, addressed the distinction as follows:

> The modern view is that when one party repudiates the contract and the other party accepts the repudiation the contract is at this point terminated or brought to an end. The contract is not, however, rescinded in the true legal sense, i.e., in the sense of being voided *ab initio* by some vitiating element. The parties are discharged of their prospective obligations under the contract as from the date of termination but the prospective obligations embodied in the contract are relevant to the assessment of damages: see *Johnson v. Agnew*, [1980] A.C. 367, [1979] 1 All E.R. 883 (H.L.), and *Moschi v. Lep Air ServicesLtd.*, [1973] A.C. 331, [1972] 2 All E.R. 393 (H.L.). [Emphasis added.]

See similarly Waddams, *supra*, at para. 629; Furmston, *supra*, at p. 287, note 12; G.H. Treitel, *The Law of Contract* (9th ed. 1995), at p. 341; S. Williston, *A Treatise on the Law of Contracts*, (3rd ed. 1970), by W.H.E. Jaeger, vol. 12, § 1454A, at p. 13; *Sail Labrador Ltd. v. Navimar Corp.* (1998), [1999] 1 S.C.R. 265 (S.C.C.) at para. 31 and 50.

42 However, merely clarifying the distinction between rescission and an accepted repudiation does not end the discussion. Since "rescission" has frequently been used to describe an accepted repudiation, courts must be sensitive to the potential for misuse. To that end, courts must analyse the entire context of the contract and give effect, where possible, to the intent of the parties. If they intended "rescission" to mean "an accepted repudiation," then the contract should be interpreted as such. For example, in *Mills v. S.I.M.U. Mutual Insurance Assn.*, [1970] N.Z.L.R. 602 (New Zealand C.A.), the court held that a clause stating that in the event of false statements the policy "shall be void," was in fact a repudiation clause. Crucial to the court's reasoning in that case was the fact that the clause in question provided for forfeiture of premiums. Turner J. therefore concluded, at p. 609, that

> the policy does not provide that the consequences of an untrue statement shall be that the policy shall be deemed void *ab initio*, as if it had never come into existence, for the premium is to be forfeited ... I therefore construe the clause to mean that an untrue statement shall entitle the respondent to repudiate liability under the policy, while keeping the premium.

Of course, contrary to the facts in this appeal, the actual term "rescission" was not used in *Mills*. Nonetheless, we must always examine whether the use of the word rescission is indeed consistent with the parties' intent.

43 Before turning to the issue of intent, however, one must determine whether rescission is even available. As Treitel notes regarding the law in England, *supra*, at p. 347,

> Before the Misrepresentation Act it was clear that a person could rescind a contract for a misrepresentation which did *not* form part of the contract; but it was doubtful whether this right to rescind survived where the misrepresentation was later incorporated into the contract as one of its terms. [Emphasis in original.]

However, the *Misrepresentation Act 1967* (U.K.), 1967, c. 7, s. 1, cleared up that question in England, providing that "a person shall be entitled to rescind notwithstanding that the misrepresentation has become a term of the contract" (Treitel, *supra*, at p. 347).

44 In Canada, the issue is somewhat less clear. The state of the law is best summarized by Waddams, *supra*, at para. 427:

> If the [misrepresentation] is a term of the contract ... the mistaken party is entitled to damages as for breach of contract. Whether the party is further entitled to set aside the transaction and demand restitution of the contractual benefits transferred will depend upon ... whether the breach is "substantial" or "goes to the root of" the contract.

A breach that is "substantial" or "goes to the root of" the contract is often also described as a material breach; see, for example, Fridman, *supra*, at p. 293: "A misrepresentation is a misstatement of some fact which is material to the making or inducement of a contract." The misrepresentation in this case was in the application, and was thereby incorporated into the Bond. Specifically, the misrepresentation complained of was, as stated in Guarantee's August 5, 1992 letter to Gordon that

> in respect of customer accounts a partner, officer or other designated responsible employee who has no other duties in connection with the account [would] review[] each account monthly checking for excessive or improper activity. The proof of loss discloses that no one other than Rachar was charged with reviewing the accounts in question.

The question, in light of the law as stated in Waddams, *supra*, and Fridman, *supra*, is whether the misrepresentation is "substantial," "material," or "goes to the root of" the contract. This brings us back to the issue of the parties' intent, for whether the rescission is warranted is at least in part a question of intent.

45 Whether the misrepresentation is material is a complicated question on which there is an extensive body of case law. However, these precedents are not entirely apposite, as they generally do not involve contracts, like this one, that use the term "rescission" to define the remedy for a misrepresentation in the application. The rescission clause in this appeal reads as follows:

> The Insured represents that the information furnished in the application for this bond is complete, true and correct. Such application constitutes part of this bond.
>
> Any misrepresentation, omission, concealment or incorrect statement of a material fact, in the application or otherwise, shall be grounds for the rescission of this bond. [Emphasis added]

By stating that a misrepresentation in the application would be grounds for rescission, the parties effectively stated their intent that such a misrepresentation is "substantial" and "goes to the root of" the contract. The reference to misrepresentations of "*material* fact" suggests the same conclusion. These are sophisticated parties that can be expected to know the meaning of fundamental legal terms such as "rescission," and it is appropriate to give effect to their intent as expressed in the plain words of the contract. As stated by Wilson J. in *Syncrude Canada Ltd. v. Hunter Engineering Co.*, [1989] 1 S.C.R. 426 (S.C.C.) at p. 505, "parties of equal bargaining power should be allowed to make their own bargains," See similarly *ibid.*, at p. 458, *per* Dickson C.J. This point is discussed more fully *infra*, at paras. 54-56.

46 Aside from our general reluctance to disturb the choice of terms by sophisticated commercial parties, we note in passing that the appellant not only rescinded the contract, but also tendered return of the insurance premiums. Their letter of August 5, 1992 stated their intention to rescind the policy, and they enclosed a cheque for $106,000.00, representing the premiums paid by Gordon under the policy. This distinguishes this case from *Mills*, *supra*, and demonstrates Guarantee's attempt to effect a restitution and restore the parties to the *status quo ante*, a crucial aspect of rescission. See Waddams, *supra*, at para. 424. While obviously not conclusive evidence of their contractual intentions, this evidence confirms the earlier conclusion that "rescission," as used in this contract, did indeed mean just that.

47 In summary, a misrepresentation, even one that was incorporated into the contract, gives the innocent party the option of rescinding the contract, i.e. to have it declared void *ab initio*. The misrepresentation must be "material," "substantial" or "go to the root of" the contract. We express no opinion on the availability of damages in such cases. Repudiation, by contrast, occurs when one party indicates its intention not to fulfill any future obligations under the contract. If the other party accepts the repudiation, the contract is terminated, *not rescinded.* To use "rescission" and "accepted repudiation" synonymously can lead only to confusion and should be avoided. Where there is some doubt as to whether repudiation or rescission is intended, courts should look to such factors as the context of the contract, particularly the intent of the parties. For sophisticated parties, it will take strong evidence to displace the meaning suggested by the parties' choice of language in the contract itself. In this case, because both parties agreed to the word

"rescission," and Guarantee acted in accordance with that intention, the consequence of a valid rescission based on Gordon's misrepresentation is the avoidance of the contract, and Guarantee's release from any liability thereunder.

(b) Effect of the Contractual Limitation Period Assuming Wrongful Rescission of the Bond by Guarantee

48 In the event that Gordon did not misrepresent the extent of the risk involved in applying for the fidelity bond, we can assume for the purposes of this part of the analysis that Guarantee wrongfully denied coverage to Gordon on the basis of misrepresentation. The issue then is to determine the legal consequences of a wrongful rescission. Both parties agree that a substantial failure of contractual performance, often described in other contexts as a fundamental breach, may relieve the non-breaching party from future executory obligations under the contract. The extent of disagreement between the parties concerns whether Guarantee's actions constituted a fundamental breach, and whether a time limitation provision is one such executory obligation from which the non-breaching party, here Gordon, is excused.

49 Guarantee submits that, in the event that its wrongful rescission amounts to fundamental breach, the legal consequences are governed by the decision of the Court in *Syncrude Canada Ltd., supra*. For the purposes of this appeal, the relevant portion of the decision dealt with the scope of an exclusion clause limiting liability in a contract between the purchaser, Syncrude Canada Ltd. and the vendor, Allis-Chalmers Ltd. for the supply of extraction gearboxes for Syncrude's synthetic oil plant. The supply contract included a warranty limiting Allis-Chalmer's liability to 24 months from the date of shipment or 12 months from the date the equipment was put into operation, whichever occurred first. In addition, the contract contained a clause excluding Allis-Chalmer's liability pursuant to statutory warranties or conditions. The extraction boxes were put into service in November, 1977. It was not until nearly two years later, in September, 1979, that the extraction boxes were found to be defective. Allis-Chalmers did not consider itself responsible for the costs of repair as the contractual warranty period had expired. Syncrude then sued Allis-Chalmers for breach of contract to cover the costs. At issue was whether Allis-Chalmers could enforce the clause excluding liability under the longer statutory warranty period.

50 The Court was called upon to consider the doctrine of fundamental breach, defined as a failure in the breaching party's performance of its obligations under the contract that deprives the non-breaching party of substantially the whole benefit of the agreement. Notwithstanding that in two separate minority reasons, Dickson C.J. (La Forest J. concurring) and Wilson J. (L'Heureux-Dubé J. concurring) concluded that the seriousness of the defects in the extraction boxes did not amount to a fundamental breach, both Dickson C.J. and Wilson J. discussed the legal consequences in the event that a fundamental breach had occurred. As to the circumstances in which the doctrine applied, Wilson J., at pp. 499-500, noted that the distinction between a mere contractual breach and a breach that is more appropriately characterised as fundamental is the exceptional nature of the remedy; while the traditional remedy for contractual breach is the obligation to pay damages, a fundamental breach permits the non-breaching party to elect instead to put to an end all remaining performance obligations between the parties. Given the exceptional nature of the remedy, Wilson J. rightly noted that the purpose of the restrictive definition of a fundamental breach is to limit the remedy to those circumstances where the entire foundation of the contract has been undermined.

51 As to the appropriate methodology, both Dickson C.J. and Wilson J. noted the existence of two competing views of the consequences of fundamental breach within both Canada and the United Kingdom. The traditional approach was to apply a rule of law whereby the legal effect of a fundamental breach is to bring the contract to an end. The result would be that the breaching party would be unable to rely on any contractual provisions excluding liability pursuant to common law doctrines or statutory regimes, given that the contract was treated as at an end. The alternative approach addressed the consequences of fundamental breach as a matter of construction of the terms of the contract rather than a categorical rule of law. Courts are required to determine whether the contract, properly interpreted, provides that exclusion clauses shall be enforceable in the event of fundamental breach. If, as a matter of contractual interpretation, the parties clearly intended an exclusion clause to continue to apply in the event of fundamental breach, courts were required to enforce the bargain agreed to by the parties, rather than applying a rule of law to rewrite the terms of the contract.

52 Noting that the contractual interpretation approach was adopted in England in *Photo Production Ltd. v. Securicor Transport Ltd.*, [1980] A.C. 827 (U.K. H.L.), and in prior jurisprudence of the Court (see *B.G. Linton Construction Ltd. v. Canadian National Railway* (1974), [1975] 2 S.C.R. 678 (S.C.C.); *Chomedy Aluminium Co. v. Belcourt Construction (Ottawa) Ltd.*, [1980] 2 S.C.R. 718 (S.C.C.)), both Dickson C.J. and Wilson J. affirmed that whether fundamental breach prevents the breaching party from continuing to rely on an exclusion clause is a matter of construction rather than a rule of law. The only limitation placed upon enforcing the contract as written in the event of a fundamental breach would be to refuse to enforce an exclusion of liability in circumstances where to do so would be unconscionable, according to Dickson C.J., or unfair, unreasonable or otherwise contrary to public policy, according to Wilson J.

53 Guarantee submits, pursuant to *Syncrude Canada Ltd., supra*, that it is entitled to enforce the contractual time limitation period based on the intent of the parties that the provision would survive a wrongful rescission. Gordon contends, however, that the differences between exclusion of liability clauses and time limitation provisions is sufficiently substantial that the reasoning in *Syncrude Canada Ltd., supra*, cannot be extended to apply to the factual circumstances of this appeal. We note that in *Hunter Engineering, supra*, at p. 463, Dickson C.J. expressly confined his reasons to the use of fundamental breach in the context of clauses excluding liability. In our opinion, however, the policy rationale in support of the construction approach as applied to exclusion clauses is equally applicable to provisions limiting the time in which an action can be initiated.

54 As discussed by Dickson C.J. in *Syncrude Canada Ltd., supra*, when the House of Lords rejected the rule of law approach to fundamental breach in its decision in *Photo Production, supra*, Lord Wilberforce articulated the underlying policy rationale in favour of the construction approach as a matter of allowing the parties to make their own bargain, at p. 843, as follows:

> At the stage of negotiation as to the consequences of a breach, there is everything to be said for allowing the parties to estimate their respective claims according to the contractual provisions they have themselves made. ...
>
> At the judicial stage there is still more to be said for leaving cases to be decided straightforwardly on what the parties have bargained for rather than upon analysis, which becomes progressively more refined, of decisions in other cases leading to inevitable appeals.

55 Wilson J. noted that Lord Diplock, in his concurring reasons in *Photo Production, supra*, articulated a similar policy concern, stressing that in circumstances where the parties possess equal bargaining power, they should be permitted to make their own bargain and should be held to its terms accordingly, at p. 851:

> In commercial contracts negotiated between business-men capable of looking after their own interests and of deciding how risks inherent in the performance of various kinds of contract can be most economically borne (generally by insurance), it is, in my view, wrong to place a strained construction upon words in an exclusion clause which are clear and fairly susceptible of one meaning only. ...

56 Contrary to Gordon's submission, our analysis is more properly focussed not on formal comparisons between exclusion clauses and time limitation provisions, but on the underlying policy rationale that directs courts to the appropriate circumstances for intervention. In terms of negotiating the consequences of a breach of contract, including a fundamental breach, and the role of courts in upholding the bargain struck by commercial parties with equal bargaining power, we do not see any principled distinction between clauses excluding liability and those setting out the applicable limitation periods such that courts should respect the bargain made by the parties in the former case but not in the latter. Indeed, the argument for applying the construction approach may be even more compelling in the case of contractual limitation periods, as the subject matter directly relates to the parties' intentions in the event of non-performance. Given that no reason exists in terms of policy to limit the construction approach to fundamental breach to exclusion clauses alone, we consider the circumstances of this appeal appropriate for extending the relevant principles set out in *Syncrude Canada Ltd., supra*, to interpretation of contractual time limitation periods.

57 We find additional judicial support for our position in the reasons of the Privy Council in *Salmond & Spraggon (Australia) Propriety Ltd. v. Port Jackson Stevedoring Propriety Ltd.* (1980), [1981] 1 W.L.R. 138 (Australia P.C.). An employee of the Port Jackson Stevedoring Propriety Ltd. had mistakenly delivered goods in the care of the consignee, Salmond & Spraggon (Aust.) Propriety Ltd., to unauthorised persons such that the shipment was in effect stolen. The bill of lading contained a "Himalaya clause" extending the benefit of defences and immunities from the carrier to independent contractors employed by the carrier, as well as a contractual limitation period barring any action not initiated within one year after the delivery of the goods. The stevedore relied upon both of these provisions as a defence to the action by the consignee. The consignee argued, however, that owing to the fundamental nature of the breach, the stevedore was no longer entitled to rely on the time bar provision. The basis of the consignee's submission on this point was that the requirement to bring suit within one year was an executory obligation imposed upon the non-breaching party, and that the stevedore's fundamental breach relieved the consignee of performing this obligation.

58 Delivering the judgment of the Privy Council, Lord Wilberforce dismissed the consignee's arguments on this point as both "unsound" and "unreal." He reasoned that a provision setting out a time limitation period for bringing a cause of action cannot be characterised as an executory obligation. Instead, the provision becomes relevant precisely at the point when performance becomes impossible, as it regulates the time period in which liability for breach of contract is to be established. Adopting the construction approach to fundamental breach from *Photo Production, supra*, Lord Wilberforce concluded at p. 145 that "on construction and analysis," the contractual limitation period "plainly operates to exclude the consignee's claim."

59 Given that the decision of the Privy Council in *Salmond & Spraggon, supra*, and that of the Court in *Syncrude Canada Ltd., supra*, share a common doctrinal antecedent in *Photo Production, supra*, we consider the decision in *Salmond & Spraggon, supra*, to be persuasive authority in support of Guarantee's submission that the principles in *Syncrude Canada Ltd., supra*, concerning fundamental breach can apply to determine the status of the contractual limitation period in the event of Guarantee's purported wrongful rescission of the Bond. There is no sound basis in policy, principle or existing jurisprudence in support of Gordon's submission that the construction approach to fundamental breach should be limited to cases of exclusion clauses alone.

60 Having established that the construction approach to fundamental breach as set out in *Syncrude Canada Ltd., supra*, can apply to circumstances involving a contractual limitation period, we must now decide whether, as a matter of contractual interpretation, Guarantee and Gordon intended section 5(d) of the Bond, limiting the time period for initiating an action to 24 months, to survive a wrongful rescission on the part of Guarantee. To answer this question, we do not find it necessary to decide whether a wrongful rescission constitutes a fundamental breach. If the wrongful rescission was just a simple breach, then the limitation period applies. Even if the wrongful rescission was a fundamental breach, then the limitation period will still apply, for the reasons we give below. Therefore, as the limitation period will apply in any event, it is unnecessary to decide whether the wrongful rescission constitutes a fundamental breach.

61 Applying the construction approach from *Syncrude Canada Ltd., supra*, to the present appeal, we conclude that the limitations period survives. In determining whether it was the intention of the parties that the contractual limitation period would survive a purported wrongful rescission by Guarantee such that the present action by Gordon is time-barred, commercial reality is often the best indicator of contractual intention in circumstances such as this. If a given construction of the contract would lead to an absurd result, the assumption is that this result could not have been intended by rational commercial actors in making their bargain, absent some explanation to the contrary.

62 We are also unable to accept Gordon's submission that the time limitation clause could not be invoked once Guarantee had taken steps to enforce the contractual provision permitting rescission on the basis of a purported misrepresentation by Gordon during the application process. This would lead to an absurd result in that Guarantee, when faced with a potential misrepresentation concerning the degree of risk it has agreed to underwrite, would be placed in the untenable position of subjecting itself to a longer statutory limitation period than would otherwise apply in circumstances where coverage has been denied for other reasons. Commercial reality cannot accommodate the implication of Gordon's

submission, which would be that Guarantee agreed to a bargain whereby it would be exposed to a longer period of uncertainty concerning future claims from an insured who has purportedly engaged in misrepresentation than one who has complied with all of the contractual terms.

63 We are also of the view that notwithstanding Gordon's contention that the contractual limitation provision should be narrowly construed so as to exclude the present action from its scope, the language of section 5(d) in terms of "any loss hereunder" is unambiguous. While Gordon submits that the placement of the provision in the claims section of the Bond is dispositive of the matter, we attach more significance to the fact that the contractual limitation period was not subject to qualifying language of any kind limiting the scope of the phrase to the claims process alone. Instead, upon a true construction of the contract, and taking into account the stated purpose of a contractual limitation period as a device whereby the insurer can both quantify and limit risk, we conclude that the intention of the parties was that section 5(d), setting out the 24-month limitation period, was intended to include the process of bringing a claim against the insurer in circumstances of contractual breach, whether fundamental or otherwise.

64 At this point, we now turn to consider the additional qualification set out in *Syncrude Canada Ltd., supra*, whereby the parties are held to the terms of their agreement provided that the result is not unconscionable, as *per* Dickson C.J., or unfair, unreasonable or otherwise contrary to public policy, as *per* Wilson J. As we have already noted, the parties to this appeal, an insurance company and an investment dealer and brokerage firm, are sophisticated commercial actors. In addition, both parties were represented by counsel. In *Syncrude Canada Ltd., supra*, these factors were sufficient for both Dickson C.J. and Wilson J. to conclude that had the doctrine of fundamental breach applied, no reason existed for the Court to refuse to enforce the bargain made between the parties in terms of the clause governing exclusion of liability. Similarly, we conclude that it would not be unconscionable, unfair, unreasonable or otherwise contrary to public policy to uphold the intentions of the parties concerning the operation of the contractual limitation period in these circumstances.

IV. Disposition

65 We have concluded that the motions judge did not err in determining that the record was sufficient to deal with Guarantee's motion for summary judgment. O'Brien J. was correct in concluding, pursuant to section 3 of the Bond pertaining to discovery of loss, that it could reasonably be inferred from the record that a loss of the type covered by the policy was or would be incurred. We also see no reason to disturb his finding that a genuine issue of credibility did not exist. As to the legal consequences of a valid rescission, we have concluded that the limitations period is irrelevant because the contract would be treated as being void *ab initio*, releasing Guarantee from any liability thereunder. In addition, assuming that Guarantee's conduct amounted to wrongful rescission, upon a true construction of the time limitation provision, the parties intended the limitation period to govern the litigation process post-breach, whether fundamental or otherwise. To enforce the bargain made by the parties in these circumstances would not be unconscionable, unfair, unreasonable, or otherwise violate public policy.

66 Accordingly, we would allow the appeal, set aside the judgment of the Court of Appeal of Ontario, and restore the decision of O'Brien J. granting summary judgment in favour of Guarantee, with costs throughout.

Appeal allowed.

Pourvoi accueilli.

TAB 17

2002 SCC 19, 2002 CSC 19
Supreme Court of Canada

Sylvan Lake Golf & Tennis Club Ltd. v. Performance Industries Ltd.

2002 CarswellAlta 186, 2002 CarswellAlta 187, 2002 SCC 19, 2002 CSC 19, [2002] 1 S.C.R. 678, [2002] 5 W.W.R. 193, [2002] S.C.J. No. 20, 111 A.C.W.S. (3d) 733, 209 D.L.R. (4th) 318, 20 B.L.R. (3d) 1, 266 W.A.C. 201, 283 N.R. 233, 299 A.R. 201, 50 R.P.R. (3d) 212, 98 Alta. L.R. (3d) 1, J.E. 2002-448, REJB 2002-28038

Performance Industries Ltd. and Terrance O'Connor, Appellants/Respondents on Cross-Appeal v. Sylvan Lake Golf & Tennis Club Ltd., Respondent/Appellant on Cross-Appeal

McLachlin C.J.C., L'Heureux-Dubé, Gonthier, Major, Binnie, Arbour, LeBel JJ.

Heard: December 14, 2000
Judgment: February 22, 2002 *
Docket: 27934

Proceedings: affirming (2000), 185 D.L.R. (4th) 269 (Alta C.A.); reversing in part (1999), 49 B.L.R. 284 (Alta. Q.B.)

Counsel: *David R. Haigh, Q.C.*, and *Brian Beck*, for appellants/respondents on cross-appeal
Lowell Westersund and *Munaf Mohamed*, for respondent/appellant on cross-appeal

Subject: Contracts; Corporate and Commercial; Civil Practice and Procedure; Property

Headnote

Contracts --- Rectification or reformation — Prerequisites — Mistake — Unilateral

Parties entered into written agreement, which, by virtue of defendant's fraud, did not reflect their earlier oral agreement — Plaintiff was entitled to rectification.

Contracts --- Rectification or reformation — Bars to rectification

Parties entered into written agreement, which, by virtue of defendant's fraud, did not reflect their earlier oral agreement — Plaintiff was entitled to rectification — Plaintiff's lack of due diligence was not defence to rectification.

Damages --- Damages in contract — Loss of profits consequent to breach — General principles

Parties entered into written agreement, which, by virtue of defendant's fraud, did not reflect their earlier oral agreement — Plaintiff was entitled to compensatory damages for breach of contract as rectified, including losses flowing from special circumstances known to parties when contract was made.

Damages --- Exemplary, punitive and aggravated damages — Grounds for awarding exemplary, punitive and aggravated damages — Fraud

Parties entered into written agreement, which, by virtue of defendant's fraud, did not reflect their earlier oral agreement — Plaintiff was entitled to rectification — Punitive damages award was not appropriate because compensatory damages adequately achieved objectives of retribution, deterrence, and denunciation.

Sale of land --- Remedies — Rectification — Of agreement

Parties entered into written agreement, which, by virtue of defendant's fraud, did not reflect their earlier oral agreement — Plaintiff was entitled to rectification.

Sale of land --- Remedies — Damages — Measure of damages

Parties entered into written agreement, which, by virtue of defendant's fraud, did not reflect their earlier oral agreement — Plaintiff was entitled to compensatory damages for breach of contract as rectified, including losses flowing from special circumstances known to parties when contract was made.

Contrats --- Rectification ou réformation — Conditions préalables — Erreur — Unilatérale

Parties ont conclu un contrat écrit qui ne reflétait pas leur entente verbale antérieure en raison de la fraude commise par le défendeur — Demanderesse avait le droit d'obtenir la rectification.

Contrats --- Rectification ou réformation — Motifs interdisant la rectification

Parties ont conclu un contrat écrit qui ne reflétait pas leur entente verbale antérieure en raison de la fraude commise par le défendeur — Demanderesse avait le droit d'obtenir la rectification — Manque de diligence raisonnable de la part de la demanderesse n'empêchait pas la rectification.

Dommages --- Dommages contractuels — Perte de profits à la suite du manquement — Principes généraux

Parties ont conclu un contrat écrit qui ne reflétait pas leur entente verbale antérieure en raison de la fraude commise par le défendeur — Demanderesse avait le droit d'obtenir des dommages-intérêts compensatoires pour la rupture du contrat rectifié, y compris pour les pertes découlant des circonstances spéciales qui étaient connues des parties au moment de la conclusion du contrat.

Dommages --- Dommages exemplaires, punitifs ou additionnels — Motifs permettant d'accorder des dommages exemplaires, punitifs ou additionnels — Fraude

Parties ont conclu un contrat écrit qui ne reflétait pas leur entente verbale antérieure en raison de la fraude commise par le défendeur — Demanderesse avait le droit d'obtenir la rectification — Décision d'accorder des dommages punitifs n'était pas appropriée vu que les dommages-intérêts compensatoires permettaient de répondre adéquatement aux objectifs de punition, dissuasion et dénonciation.

Vente de bien-fonds --- Réparations — Rectification — Du contrat

Parties ont conclu un contrat écrit qui ne reflétait pas leur entente verbale antérieure en raison de la fraude commise par le défendeur — Demanderesse avait le droit d'obtenir la rectification.

Vente de bien-fonds --- Réparations — Dommages-intérêts — Évaluation des dommages

Parties ont conclu un contrat écrit qui ne reflétait pas leur entente verbale antérieure en raison de la fraude commise par le défendeur — Demanderesse avait le droit d'obtenir des dommages-intérêts compensatoires pour la rupture du contrat rectifié, y compris pour les pertes découlant des circonstances spéciales qui étaient connues des parties au moment de la conclusion du contrat.

The plaintiff and the individual defendant entered into a verbal agreement to purchase a golf course as a joint venture, with the plaintiff and the corporate defendant each holding a one-half interest as tenants in common. The plaintiff would operate the facilities for five years for its own account, at the end of which time the defendants would buy out the plaintiff. The parties verbally agreed that the plaintiff had an option for a residential development on part of the property. The parties signed a written agreement, prepared by the defendants' lawyer, permitting the development of a strip of land 110 feet wide, rather than the 110 yards wide to which the parties had verbally agreed. The president of the plaintiff did not read the agreement before signing it. When the plaintiff proposed to build a residential development on part of the property, the individual defendant rejected the plan by invoking the clause that restricted development to 110 feet. At the end of the five-year term, the plaintiff refused to relinquish possession of the land. The defendants obtained an order for specific performance and built a clubhouse on the

disputed property. The plaintiff brought an action for rectification of the agreement, or damages in lieu, and for punitive damages and solicitor and client costs.

The trial judge allowed the plaintiff's action for damages and found that the plaintiff had mistakenly believed that the written agreement reflected the verbal agreement and that the individual defendant had chosen not to inform the plaintiff of the mistake. The trial judge found that the individual defendant's actions were fraudulent, dishonest, and deceitful, and provided the necessary support for lifting the corporate veil. The trial judge held the individual defendant personally liable, jointly and severally with his company, for $620,100 in damages, the amount of money to which the president of the plaintiff would have been entitled had he been permitted to complete the residential development in accordance with the terms of the rectified option clause. The trial judge awarded the plaintiff $200,000 for punitive damages. For their misbehaviour in the conduct of the action, the defendants were required to pay solicitor and client costs.

The Court of Appeal allowed the defendants' appeal in part. The court found that the trial judge had sufficient evidence upon which to base his conclusions on the plaintiff's unilateral mistake and the individual defendant's misconduct. The quantum of damages for loss of opportunity was generous but the court did not interfere with the award. The misconduct of the defendants was outrageous, but the compensatory damages awarded adequately satisfied the goals of punishment and deterrence. No valid reason was given for imposing punitive damages, so that award was disallowed. The trial judge had ample bases upon which to exercise his discretion and award solicitor and client costs.

The defendants appealed. The plaintiff cross-appealed, seeking restoration of the punitive damages award.

Held: The appeal and the cross-appeal were dismissed with costs.

Per Binnie J. (McLachlin C.J.C., L'Heureux-Dubé, Gonthier, Major, Arbour JJ. concurring): The plaintiff was entitled to rectification as it met all the conditions precedent required for the remedy. The plaintiff established that the terms to which it had orally agreed were not properly written down. The trial judge found that the parties had made a verbal agreement with respect to a definite project in a definite location, although they did not discuss a metes and bounds description. The individual defendant fraudulently misrepresented the written document as accurately reflecting the terms of the prior oral contract. He knew that the plaintiff would not sign an agreement without the option for sufficient land to create a development with two rows of housing as specified in the prior oral contract; therefore, he knew that when the plaintiff signed the document, the plaintiff had not detected the substitution of 110 feet for 110 yards. The trial judge characterized the individual defendant's actions as "fraudulent, dishonest and deceitful." The trial judge made his key findings in respect of the prior oral agreement, the unilateral mistake of the plaintiff's president, and the individual defendant's knowledge of that mistake to a standard of "beyond any reasonable doubt."

The plaintiff's lack of due diligence was not a defence to rectification because the plaintiff sought no more than to enforce the prior oral agreement to which the defendants had already bound themselves. The president of the plaintiff had left the documentation to his lawyer without appreciating that he had given his lawyer insufficient information to check the individual defendant's figures, and, at that time, he no reason to question the individual defendant's integrity. Furthermore, the plaintiff's lack of due diligence provided no defence because of the individual defendant's fraud. The individual defendant undertook, as part of the verbal agreement, to have a document prepared setting out the terms of the agreement. The trial judge found that part of the individual defendant's fraudulent scheme was to have the document wrongly state the terms of the option, to misrepresent fraudulently to the plaintiff that the document accurately set out their verbal agreement, to allow the plaintiff to sign the document when the individual defendant knew that the plaintiff was mistaken in doing so, and then to delay any response to

the plaintiff's development proposals until it was almost too late for the development to proceed. The individual defendant admitted providing his lawyer with the erroneous metes and bounds description in the option clause.

There was no reason to disturb the trial judge's award of $620,100 in compensatory damages. The parties specifically contemplated that the optioned land would be used for residential housing and the damages for breach of the contract, as rectified, therefore properly included losses flowing from the special circumstances known to the parties when they made their contract. Although the Court of Appeal characterized the compensatory award as "substantial and generous," it was not prepared to interfere with the award and, in the absence of an error of principle or a factual record that supported the defendants' criticisms, there was no reason to interfere with the award.

The award of punitive damages did not serve a rational purpose. Punitive damages are rational only if compensatory damages do not adequately achieve the objectives of retribution, deterrence, and denunciation, which was not the case here. This case involved a commercial relationship between businessmen who were equals. Although the individual defendant's misconduct was planned and deliberate and lasted for four and one-half years, the plaintiff obtained full compensation plus costs on a solicitor and client basis, which had a punitive effect on the individual defendant.

La demanderesse et le défendeur, un particulier, ont conclu une entente verbale selon laquelle ils devaient former une coentreprise pour acheter un terrain de golf par laquelle la demanderesse et la défenderesse, une personne morale, seraient copropriétaires et détiendraient chacune une participation de 50 pour cent. La demanderesse devait exploiter les installations pendant cinq ans pour son propre compte et, par la suite, les défendeurs devaient racheter la part de la demanderesse. Les parties se sont entendues verbalement sur une option que pouvait soulever la demanderesse dans le but de construire un complexe résidentiel sur une partie du terrain. Les parties ont signé un contrat écrit, rédigé par l'avocat des défendeurs, qui autorisait la construction sur une bande de terrain large de 110 pieds plutôt que de 110 verges, comme il avait été convenu verbalement par les parties. Le président de la demanderesse n'a pas lu le contrat avant de le signer. La demanderesse a soumis une proposition pour construire le complexe résidentiel sur une partie du terrain, mais le défendeur a refusé le projet en invoquant la clause du contrat qui limitait le développement sur une largeur de 110 pieds. Lorsque le délai de cinq ans a expiré, la demanderesse a refusé d'abandonner la possession du terrain. Les défendeurs ont obtenu un jugement ordonnant l'exécution forcée et ont construit un pavillon sur le terrain en litige. La demanderesse a intenté une action pour obtenir la rectification du contrat ou bien des dommages-intérêts; elle a aussi réclamé des dommages punitifs et les dépens sur une base avocat-client.

Le juge de première instance a accueilli l'action en dommages-intérêts de la demanderesse; il a estimé que la demanderesse avait cru par erreur que le contrat écrit reflétait les termes de l'entente verbale et que le défendeur avait décidé ne pas informer la demanderesse qu'il y avait une erreur dans le contrat. Le juge de première instance a conclu que la conduite du défendeur avait été frauduleuse, malhonnête et dolosive et qu'elle constituait un motif suffisant pour lever le voile corporatif. Il a déclaré le défendeur solidairement responsable avec sa société du paiement des dommages-intérêts de 620 100 $, lesquels dommages étaient équivalents au montant auquel aurait eu droit la demanderesse si elle avait eu la possibilité de compléter son projet résidentiel conformément aux termes de la clause d'option rectifiée. Le juge a accordé 200 000 $ à la demanderesse à titre de dommages punitifs. À cause de leur mauvaise conduite lors du déroulement de l'instance, les défendeurs ont été condamnés à payer les dépens sur une base avocat-client.

La Cour d'appel a accueilli en partie le pourvoi des défendeurs. La Cour a estimé que le juge de première instance avait suffisamment de preuve pour fonder ses conclusions relatives à l'erreur unilatérale de la demanderesse et à la mauvaise conduite du défendeur. Même si les dommages-intérêts accordés pour la perte d'une possibilité étaient généreux, ils n'ont pas été modifiés. La conduite du défendeur était scandaleuse, mais les dommages-intérêts compensatoires accordés répondaient de façon adéquate aux objectifs de punition et de dissuasion. Aucune raison

valable n'a été donnée pour l'attribution de dommages punitifs et l'attribution de ces dommages a été annulée. Le juge de première instance avait amplement de preuve pouvant lui permettre d'exercer son pouvoir discrétionnaire et d'accorder des dépens sur une base avocat-client.

Les défendeurs ont interjeté appel. La demanderesse a formé un appel incident dans lequel elle a demandé que la décision relative aux dommages punitifs soit rétablie.

Arrêt: Le pourvoi et le pourvoi incident ont été rejetés avec dépens.

Binnie, J. (McLachlin, J.C.C., L'Heureux-Dubé, Gonthier, Major, Arbour, JJ., souscrivant) : La demanderesse avait le droit d'obtenir la rectification parce qu'elle a satisfait à toutes les conditions préalables donnant ouverture à ce moyen de réparation. La demanderesse a prouvé que les termes du contrat sur lesquels elle s'était entendue verbalement avec les défendeurs n'avaient pas été transcrits convenablement. Le juge de première instance a déterminé que les parties avaient conclu une entente verbale relativement à un projet précis devant être construit à un endroit précis, bien que les parties n'avaient pas discuté de la description technique du terrain. Le défendeur a fait une assertion inexacte et frauduleuse en laissant croire que le document écrit représentait fidèlement les termes de l'entente verbale antérieure. Il savait que la demanderesse ne signerait pas le contrat si ce dernier ne contenait pas une option visant suffisamment de terrain pour pouvoir y développer un complexe de deux rangées de maisons tel qu'il avait été spécifié dans le cadre de l'entente verbale antérieure. Par conséquent, il savait que la demanderesse n'avait pas vu que 110 verges avait été remplacé par 110 pieds lorsque celle-ci a signé le contrat. Le juge de première instance a qualifié les actions du défendeur de « frauduleuses, malhonnêtes et dolosives ». C'est au regard de la norme de preuve « hors de tout doute raisonnable » que le juge a tiré ses conclusions clés à l'égard de l'entente verbale antérieure, de l'erreur principale et unilatérale de la demanderesse et de la connaissance par le défendeur de l'erreur.

Le manque de diligence raisonnable de la part de la demanderesse ne l'empêchait pas d'obtenir la rectification puisqu'elle voulait seulement faire respecter l'entente verbale antérieure qui liait déjà le défendeur. La demanderesse a laissé aux avocats la charge de rédiger le contrat sans se rendre compte qu'elle n'avait pas donné assez d'information à son avocat pour lui permettre de vérifier les chiffres du défendeur. De plus, elle n'avait pas de raison, à ce moment-là, de douter du défendeur. En outre, le manque de diligence raisonnable de la part de la demanderesse ne constituait pas une défense vu la fraude perpétrée par le défendeur. Dans le cadre de l'entente verbale, le défendeur s'était engagé à faire mettre par écrit les modalités du contrat. Le juge de première instance a estimé que le défendeur, dans le cadre de son stratagème frauduleux, avait fait en sorte que le document énonce erronément les modalités de l'option; que le défendeur avait laissé croire à la demanderesse, de manière frauduleuse et inexacte, que le document reflétait adéquatement leur entente verbale; que le défendeur avait laissé la demanderesse signer le contrat alors qu'il savait très bien que la demanderesse commettait une erreur en le signant; et que le défendeur avait retardé toute réponse aux propositions de développement de la demanderesse jusqu'à ce qu'il soit devenu presque trop tard pour réaliser le projet de construction. Le défendeur a admis avoir donné à son avocat la description technique erronée qui figurait dans la clause relative à l'option.

Il n'y avait aucun motif pouvant justifier de modifier la somme de 620 000 $ que le juge de première instance avait accordé à titre de dommages-intérêts compensatoires. Les parties avaient spécifiquement envisagé que le terrain faisant l'objet de l'option serait utilisé pour y construire un projet résidentiel. Par conséquent, les dommages-intérêts compensatoires accordés pour la rupture du contrat rectifié incluaient à bon droit les pertes découlant des circonstances spéciales qui étaient connues des parties au moment de la conclusion du contrat. Même si la Cour d'appel a qualifié les dommages-intérêts compensatoires de « substantiels et généreux », elle n'était pas disposée à les modifier et, en l'absence d'une erreur de principe ou d'éléments factuels pouvant appuyer les critiques formulées par les défendeurs, il n'y avait pas de raison de modifier cette conclusion.

La décision d'accorder des dommages punitifs ne répondait à aucun objectif rationnel. Une telle décision n'est rationnelle que lorsque les dommages compensatoires ne permettent pas de répondre adéquatement aux objectifs de punition, dissuasion et dénonciation, ce qui n'était pas le cas en l'espèce. Il s'agissait d'une relation commerciale entre des hommes d'affaires qui étaient tous deux sur un pied d'égalité. Même si la conduite du défendeur a été préméditée, délibérée et qu'elle a duré pendant quatre ans et demie, la demanderesse a été pleinement indemnisée et elle s'est vu adjugé les dépens sur une base avocat-client, ce qui a eu un effet punitif sur le défendeur.

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APPEAL by defendants from judgment reported at 2000 CarswellAlta 360, [2000] A.J. No. 408, 2000 ABCA 116, (sub nom. *Sylvan Lake Golf & Tennis Club Ltd. v. Performance Industries Ltd. (No. 2))* 255 A.R. 329, 220 W.A.C. 329, 6 B.L.R. (3d) 24 (Alta. C.A.), allowing in part defendants' appeal from judgment allowing plaintiff's action for damages and holding individual defendant personally liable jointly and severally with his company for $620,100 in damages, awarding plaintiff $200,000 in punitive damages, and solicitor and client costs, reported at 1999 CarswellAlta 599, [1999] A.J. No. 741, 49 B.L.R. (2d) 284, 246 A.R. 272 (Alta. Q.B.); CROSS-APPEAL by plaintiff seeking restoration of punitive damages award.

POURVOI des défendeurs à l'encontre de l'arrêt publié à 2000 CarswellAlta 360, [2000] A.J. No. 408, 2000 ABCA 116, (sub nom. *Sylvan Lake Golf & Tennis Club Ltd. v. Performance Industries Ltd. (No. 2))* 255 A.R. 329, 220 W.A.C. 329, 6 B.L.R. (3d) 24 (Alta. C.A.), qui a accueilli en partie le pourvoi des défendeurs à l'encontre du jugement qui avait accueilli l'action intentée par la demanderesse, déclaré le défendeur particulier solidairement responsable avec sa société du paiement d'une somme de 620 000 $ à titre de dommages-intérêts et accordé à la demanderesse une somme de 200 000 $ à titre de dommages punitifs ainsi que les dépens sur une base avocat-client, publié à 1999 CarswellAlta 599, [1999] A.J. No. 741, 49 B.L.R. (2d) 284, 246 A.R. 272 (Alta. Q.B.); POURVOI INCIDENT de la demanderesse afin que soit rétablie l'attribution de dommages punitifs.

***Binnie J.* (*McLachlin C.J.C.*, *L'Heureux-Dubé*, *Gonthier*, *Major*, *Arbour JJ.* concurring):**

1 In this appeal the Court is called on to deal with rectification of a contract for a real estate development dream that turned into a nightmare for the warring partners. Houses were to have been built along the 18th fairway of the Sylvan Lake Golf Course, within commuting distance of Red Deer, Alberta. It did not happen because the parties fell out over the amount of land to be included in the development contract.

2 There was a written contract but the respondent's President did not bother to read it before it was signed. Had he done so, the error in reducing the parties' prior oral agreement to writing would likely have been detected and the development would have gone ahead. The appellants, who rely on the written document, say that a party who fails to exercise due diligence in its business affairs should be refused the equitable remedy of rectification. That is their strongest argument.

3 The principal witness and "directing mind" of the appellant Performance Industries Ltd. ("Performance"), which stands firm on the written document, is Terrance O'Connor. For him, the joint venture ended with his actions being characterized by the trial judge as "fraudulent, dishonest and deceitful" ((1999), 246 A.R. 272 , at para. 114). The trial judgment made him personally liable (jointly and severally with his company Performance Industries Ltd.) for $1,047,810, including a $200,000 award of punitive damages, plus costs on a solicitor-client basis. He and his company appeal to this Court on various errors of law, few of which were argued before the trial judge.

4 For his erstwhile partner, Frederick Bell, whose corporate vehicle is Sylvan Lake Golf & Tennis Club Ltd. ("Sylvan"), his commercial aspirations have been trapped in the courts for seven years. This was because, so the trial judge found, O'Connor swore false affidavits, refused to produce relevant documents, gave false testimony in the course of two separate trials, and did "everything in his power to prevent the truth from coming to light" (para. 115). Bell is now said to be a spent force, "divorced [and lacking] the initiative or drive and determination to proceed with such a development at his present age" (para. 90). Bell obtained a $200,000 punitive damage award at trial, but this was disallowed by the Alberta Court of Appeal ((2000), 255 A.R. 329, 2000 ABCA 116). In its cross-appeal, his company, Sylvan, seeks restoration of that award.

5 Because of the punitive damages issues, this appeal was heard concurrently with *Whiten v. Pilot Insurance Co.*, 2002 SCC 18 (S.C.C.), judgment, which is being released concurrently with this judgment.

6 In my view, for reasons which differ somewhat from the memorandum of judgment handed down by the Alberta Court of Appeal, the appeal should be dismissed with costs and the cross-appeal should be dismissed without costs.

I. Facts

7 Sylvan had operated a 171.53 acre, 18-hole golf course since 1979 under a lease which gave it a right of first refusal in the event the owner decided to sell the land. On November 3, 1989, a purchaser unrelated to O'Connor or Performance offered to purchase the golf course property for $1.3 million. Sylvan then had until December 31, 1989, to make the purchase on the same terms and conditions. The outside offer triggered the chain of events that led to this action.

8 O'Connor was familiar with the Sylvan Lake Golf Course, having played it frequently and having hosted his corporate tournament at that site for some years.

9 O'Connor, unbeknownst to Bell, had approached the landowner with a view to purchasing the leased golf course property, without result. He had obtained a financing commitment as early as March 31, 1989, from the Federal Business Development Bank ("FBDB"). On learning that Sylvan had exercised its right of first refusal, O'Connor approached Bell with an offer of financial assistance, which was declined. However, when Bell's former partner dropped out, and Sylvan's efforts to finance the purchase of the golf course through other means proved unsuccessful, Bell went back to O'Connor. Bell testified that at that meeting he discussed with O'Connor how Bell wanted to secure another five years of operation of the golf course with a chance at the end of that time to secure his retirement by the development of the 18th hole for residential development. Negotiations for a joint venture ensued near the end of November or early December 1989.

10 After a number of preliminary meetings, O'Connor spent about two and a half hours at Bell's home during the December 16-17 weekend. The two men met at length in O'Connor's truck a day or two later. The trial judge found that Bell and O'Connor came to a verbal agreement on the terms of their joint venture. They would pool their resources plus a $700,000 mortgage from the FBDB to purchase the property. Sylvan (Bell) would thereafter operate the facilities for five years for its own account without any day-to-day involvement of O'Connor. In brief, at the conclusion of five years, Sylvan would be bought out by Performance (O'Connor) for an agreed sum less any money then outstanding on the FBDB mortgage.

11 For present purposes, the only contentious issue was the option for a residential development to be undertaken by Bell (or a third party) "along the 18th fairway." O'Connor and Bell did not discuss a metes and bounds description of the optioned land, but Bell testified, and the trial judge accepted, that he showed O'Connor photographs and plans of the sort of development he had in mind, namely, a *double* row of houses (i.e., on both sides of a street) clustered around a *cul-de-sac* along the length of the 18th fairway (480 yards). A photograph of a comparable golf course development where Bell had lived in the Bayview area of Toronto formed part of the negotiations (and was marked at trial as Exhibit 1, Tab 67). O'Connor agreed to option the land to permit such a development; otherwise (as the trial judge found), Bell would not have agreed to the five-year joint venture. The parties agreed that the purchase price of the optioned land would be $400,000 by a third party (or $200,000 if the existing owner Sylvan (Bell) chose to develop the parcel).

12 As part of the agreement, O'Connor undertook to have his lawyer reduce the verbal terms to writing. In due course, a document was produced. Clause 18, the option, accurately specified the 480-yard length of the proposed development, but instead of sufficient width to permit a double row of houses (approximately 110 *yards*), clause 18 allowed only enough land for a single row of houses (110 *feet*). This misstatement of the oral agreement was thus pleaded in para. 9 of the Statement of Claim:

> Paragraph 18 of the December 21st, 1989 written Agreement did not accurately reflect the terms of the oral agreement made between Performance and Sylvan in that it misdescribed the width of the lands subject to the Agreement as "One Hundred and Ten (110 ft.) feet in width east to west", when the width of the lands comprising the 18th hole was approximately 110 *yards* in width east to west. [emphasis in original]

Bell had in mind a development of about 58 homes on about 11 acres. O'Connor's draft allowed 3.6 acres. Bell testified, and the trial judge accepted, that he had specifically told O'Connor during the negotiations that a single row housing development (which is all that clause 18 would permit) would "be a waste of land and an uneconomic use of the 18th hole" (para. 42).

13 Clause 18 of the Joint Venture Agreement, as drawn up by O'Connor's lawyer, provided as follows:

> 18. The parties agree that sale of a portion of the lands for development of residential housing is contemplated by both of them within the term of Sylvan's tenancy. *Such portion of the lands is: one hundred ten (110 ft) feet in width east to west and approximately four hundred eighty (480 yds) yards in length north to south*, and abutted by the eastern border of the lands along its entire length. The parties agree that, if they are presented with an appropriate offer, those lands will be sold to a third party developer. It is agreed that such appropriate offer will offer the sum of at least four hundred thousand ($400,000) dollars cash for those lands and provide for the continued, uninterrupted existence of the golf course consisting of no less than six thousand two hundred fifty (6250 yds) yards in length with all eighteen fairways well divided, defined and reasonably wide (for reference sake the parties agree that the fairways of the golf course are, at the date of this agreement, for the most part well divided, defined and reasonably wide). [Emphasis added.]

14 On December 21, 1989, O'Connor and Bell signed the Joint Venture Agreement, as well as the documentation to finance the purchase of all of the land. The documents were then delivered to the solicitor for Sylvan, who reviewed it, and suggested revisions, which led to the signing of an amended Joint Venture Agreement on December 27, 1989. Sylvan's solicitor testified at trial that he did not discuss the optioned property dimensions with Bell, and Bell said he never read the option clause. All copies of the documents had been left with his lawyer. O'Connor's solicitor was not called to testify, an omission that caused the trial judge to draw the adverse inference that if the lawyer had testified, it would not have assisted O'Connor.

15 O'Connor knew from Bell's comment during the negotiations that he would not sign an agreement without the option for sufficient land to create the "Bayview" layout development with two rows of housing. Anything less would be "a waste." O'Connor therefore knew when Bell signed the document that he had not detected the substitution of 110 *feet* for 110 *yards*.

16 In 1990, Bell experienced some "cash flow difficulties" that led to a modification to the financial terms of the agreement, but pressed ahead with plans for the potential development. For a time in 1992, he worked with UMA Engineering Ltd. He subsequently retained Norman Trouth, a development consultant, who produced alternative plans and sketches for developments of 50 and 58 houses along the 18th fairway. Trouth estimated the 58-house project on or about 10.9 acres would net $820,100. In some respects, Bell was looking for more land than O'Connor had verbally agreed to. The proposals would, as contemplated from the outset, involve a measure of realignment of the 18th fairway. Bell therefore left these development proposals with O'Connor, who said he would review them. In the meantime, the

lands in the golf course had been annexed to the Town of Sylvan Lake and there was potential for development of the entire 171.5 acres, much to O'Connor's benefit.

17 Time went by. In May 1993, Bell again contacted O'Connor, who promised to review the proposal, but did not respond either then or even after a later meeting arranged by Bell's wife. The clock was running because the option required the development to be completed by December 31, 1994. Finally, by letter dated June 8, 1993, O'Connor's lawyer advised Bell that "[i]t is very unlikely that Performance Industries Ltd. will approve of any development plan which is not strictly in line with the Agreement."

18 Bell testified that at that point, for the first time, he read clause 18 and realized that it did not conform to the oral agreement. O'Connor, he concluded, had slipped in a change of dimensions that turned a viable project into "a waste of land." Bell says he was incensed. He attended at O'Connor's office for what he described as a heated meeting.

19 Attempts were made to resolve the dispute, but O'Connor continued to insist that Bell's right to develop the property was limited under clause 18 of the Agreement to a strip of land 110 feet wide on the easterly boundary of the golf course adjacent to the 18th hole. Bell continued to insist that O'Connor live up to the verbal agreement, which would require 110 feet being read as 110 yards.

20 In December 1994, the 5-year duration of the joint venture coming up for expiry, O'Connor tendered the funds required to buy out Sylvan's interest. Bell refused to allow Sylvan to relinquish possession of the land, and O'Connor commenced an action for specific performance. The Alberta Court of Queen's Bench granted an order for specific performance and O'Connor assumed possession of the property and built a clubhouse at the 18th hole. Also in late 1994, Sylvan commenced the present action against Performance and O'Connor for rectification of the Agreement or damages in lieu thereof, punitive damages and solicitor-client costs.

II. Judicial History

A. Alberta Court of Queen's Bench (1999), 246 A.R. 272

21 Wilkins J. noted that the onus was on the plaintiff "to establish both that Bell was mistaken as to the description of the development property when he signed the Agreement and that O'Connor knew of his mistake" (para. 66).

22 In the view of Wilkins J., "O'Connor's conduct in attempting to take advantage of the mistake he knew Bell to have made in signing the Agreement is equivalent to a fraud or a misrepresentation amounting [to] fraud or sharp practice" (para. 87). He concluded that "[i]t would be unjust, inequitable and unconscionable for this court not to offer redress to Bell in the face of that conduct" (para. 87). Accordingly, it was "clear from the evidence" that Bell is entitled to rectification of clause 18 of the Agreement. Sylvan was awarded damages in lieu of specific performance of the rectified Joint Venture Agreement.

23 The compensatory damages were assessed on the basis of "the amount of money that Bell would have been entitled to [receive] had he been permitted to complete the residential development of the 18th hole in accordance with the terms of the rectified clause 18" (para. 92). Wilkins J. was satisfied that a development of 58 houses could have "been constructed and substantially marketed prior to December 31, 1994" (para. 93). In the result, he assessed damages on the basis of the 58-lot development on the 480-yard 18th fairway in the amount of $820,100. From this he subtracted $200,000 (being the amount Sylvan (Bell) would have had to pay Performance (O'Connor) to exercise the $400,000 option), for a net of $620,100.

24 With respect to punitive damages, Wilkins J. reiterated that he found "the actions of O'Connor to be tantamount to fraud, equivalent to a misrepresentation in the nature of fraud, and sharp practice" (para. 109). O'Connor's "actions demand an award which will stand as an example to others and at the same time assure that [he] does not unduly profit from his conduct" (para. 109). Wilkins J. stated that "[this] latter statement is the only proper basis for an award of punitive damages" (para. 109) in this case. Accordingly, O'Connor's punitive damages should be awarded "at least to

the extent of disgorging the base profit he has realized by his improper conduct" (para. 110). Punitive damages were assessed at $200,000. For their misbehaviour in the conduct of the action, the defendants (now appellants) were required to pay solicitor-client costs.

25 O'Connor argued that he should not be personally liable for any judgment against Performance in favour of the plaintiff, but Wilkins J. rejected this argument "in its entirety" (para. 119). He said that every step taken in furtherance of this joint venture was directed by O'Connor, as was every attempt to defeat Bell's legitimate interests in the protracted litigation. "Surely there could never be a clearer case in which the court must pierce the corporate veil and attribute" (para. 119) liability personally to O'Connor. And so he did.

B. Alberta Court of Appeal (2000), 255 A.R. 329, 2000 ABCA 116

26 In a *per curiam* decision, the Court of Appeal upheld Wilkins J.'s rulings that the Agreement could be rectified and that the corporate veil could be lifted. It also upheld the damages award, with the exception of the award for punitive damages, which it set aside. The order for solicitor-client costs was similarly upheld.

27 With respect to compensatory damages, the Court of Appeal was "not prepared to interfere with the award of damages in this case" (para. 27). It did, however, describe the trial judge's award as "generous" (para. 27).

28 The Court of Appeal agreed with the trial judge that "the misconduct of the defendants was so outrageous that punishment and deterrence [were] required" (para. 28), but that punitive damages "should be awarded only if they achieve some rational purpose" (para. 28). In the Court of Appeal's view, the "substantial and generous compensatory damages awarded" (para. 29) by the trial judge satisfy both the punishment and deterrence objectives in this case. The Court of Appeal was also of the view that this was not a case where it was necessary to award punitive damages to ensure that the defendant does not profit from his misconduct. O'Connor would have profited under the Agreement even if he had not misbehaved. Accordingly, the Court of Appeal set aside the punitive damages award. In all other respects, the appeal was dismissed.

III. Analysis

29 When reasonably sophisticated business people reduce their oral agreements to written form, which are prepared and reviewed by lawyers, and changes made, and the documents are then executed, there is usually little scope for rectification. Nor does a falling out between business partners usually attract an award of punitive damages. This case is unusual because of the findings of fraud and deceit made against the appellant O'Connor by the trial judge. The appellants are therefore obliged to try to make their case, if at all, out of the mouth of Bell, with such help as they can find in the law books for their position.

30 Counsel for the appellants (who was not counsel at trial) seeks to raise three issues, which he describes as follows: (1) the relationship between the plea of unilateral mistake and the remedy of rectification (particularly where the mistake is the product of the plaintiff's own negligence), (2) the kind of pleading and proof that a plaintiff who seeks rectification must offer, as well as the proper standard of proof to apply in rectification cases, and (3) the proper method of quantifying damages ordered in lieu of rectification in cases where the subject matter of the rectified contract is an option for the sale of land. The respondent, as stated, cross-appeals against the quashing of the award of punitive damages.

A. Rectification of the Contract

31 Rectification is an equitable remedy whose purpose is to prevent a written document from being used as an engine of fraud or misconduct "equivalent to fraud." The traditional rule was to permit rectification only for mutual mistake, but rectification is now available for unilateral mistake (as here), provided certain demanding preconditions are met. Insofar as they are relevant to this appeal, these preconditions can be summarized as follows. Rectification is predicated on the existence of a prior oral contract whose terms are definite and ascertainable. The plaintiff must establish that the terms agreed to orally were not written down properly. The error may be fraudulent, or it may be innocent. What

is essential is that at the time of execution of the written document the defendant knew or ought to have known of the error and the plaintiff did not. Moreover, the attempt of the defendant to rely on the erroneous written document must amount to "fraud or the equivalent of fraud." The court's task in a rectification case is corrective, not speculative. It is to restore the parties to their original bargain, not to rectify a belatedly recognized error of judgment by one party or the other: *Hart v. Boutilier* (1916), 56 D.L.R. 620 (S.C.C.), at p. 630, "*M. F. Whalen*" *(The) v. Point Anne Quarries Ltd.* (1921), 63 S.C.R. 109 (S.C.C.), at pp. 126-127, *Downtown King West Development Corp. v. Massey Ferguson Industries Ltd.* (1996), 133 D.L.R. (4th) 550 (Ont. C.A.), at p. 558, Gerald Henry Louis Fridman, *The Law of Contract in Canada*, 4th ed. (Scarborough: Carswell, 1999), at p. 867, Stephen M. Waddams, *The Law of Contracts*, 4th ed. (Toronto: Canada Law Book, 1999), para. 336. In *Hart*, *supra*, at p. 630, Duff J. (as he then was) stressed that "[t]he power of rectification must be used with great caution." Apart from everything else, a relaxed approach to rectification as a substitute for due diligence at the time a document is signed would undermine the confidence of the commercial world in written contracts.

B. Preliminary Objection

32 The respondent says the appellants ought not to be allowed to argue various objections to rectification that were not raised at trial. The alleged uncertainty about the terms of the prior oral agreement, for example, is an issue that did not come into bloom until after the appellants had lost in the Alberta Court of Appeal. There is some merit in this objection. Unless the parties have fully addressed a factual issue at trial in the evidence, and preferably in argument for the benefit of the trial judge, there is always the very real danger that the appellate record will not contain all of the relevant facts, or the trial judge's view on some critical factual issue, or that an explanation that might have been offered in testimony by a party or one or more of its witnesses was never elicited. As Duff J. put it in *Lamb v. Kincaid* (1907), 38 S.C.R. 516 (S.C.C.), at p. 539:

> A court of appeal, I think, should not give effect to such a point taken for the first time in appeal, unless it be clear that, had the question been raised at the proper time, no further light could have been thrown upon it.

33 In my view, the appellants' contentions on the rectification issues are fact-based, but are manageable on the evidentiary record and raise important issues of law and equity. The Court is free to consider a new issue of law on the appeal where it is able to do so without procedural prejudice to the opposing party and where the refusal to do so would risk an injustice.

34 Here the respondents sought and obtained an equitable remedy to rectify a situation which need never have arisen had Bell properly read the draft document in December 1989. He who seeks equity must do equity. If equitable relief had been wrongfully granted, we should not close our eyes to a fatal objection because of counsel's oversight at trial. The facts vital to the appellants' new legal position are readily ascertainable in the evidence and the necessary findings are implicit, if not always explicit, in the trial judge's reasons.

C. The Conditions Precedent to Rectification

35 As stated, high hurdles are placed in the way of a business person who relies on his or her own unilateral mistake to resile from the written terms of a document which he or she has signed and which, on its face, seems perfectly clear. The law is determined not to open the proverbial floodgates to dissatisfied contract makers who want to extricate themselves from a poor bargain.

36 I referred earlier to the four conditions precedent, or "hurdles," that a plaintiff must overcome. To these the appellants wish to add a fifth. Rectification, they say, should not be available to a plaintiff who is negligent in reviewing the documentation of a commercial agreement. To the extent the appellants' argument is that in such circumstances the Court *may* exercise its discretion to refuse the equitable remedy to such a plaintiff, I agree with them. To the extent they say the want of due diligence (or negligence) on the plaintiff's part is an absolute bar, I think their proposition is inconsistent with principle and authority and should be rejected.

37 The first of the traditional hurdles is that Sylvan (Bell) must show the existence and content of the inconsistent prior oral agreement. Rectification is "[t]he most venerable breach in the parol evidence rule" (Waddams, *supra*, at para. 336). The requirement of a prior oral agreement closes the "floodgate" to unhappy contract makers who simply failed to read the contractual documents, or who now have misgivings about the merits of what they have signed.

38 The second hurdle is that not only must Sylvan (Bell) show that the written document does not correspond with the prior oral agreement, but that O'Connor either knew or ought to have known of the mistake in reducing the oral terms to writing. It is only where permitting O'Connor to take advantage of the error would amount to "fraud or the equivalent of fraud" that rectification is available. This requirement closes the "floodgate" to unhappy contract makers who simply made a mistake. Equity acts on the conscience of a defendant who seeks to take advantage of an error which he or she either knew or ought reasonably to have known about at the time the document was signed. Mere unilateral mistake alone is not sufficient to support rectification but if permitting the non-mistaken party to take advantage of the document would be fraud or equivalent to fraud, rectification may be available: *Hart*, *supra*, at p. 630, "*M. F. Whalen*" *(The)*, *supra*, at pp. 126-127.

39 What amounts to "fraud or the equivalent of fraud" is, of course, a crucial question. In *First City Capital Ltd. v. British Columbia Building Corp.* (1989), 43 B.L.R. 29 (B.C. S.C.), McLachlin C.J.S.C. (as she then was) observed that "in this context 'fraud or the equivalent of fraud' refers not to the tort of deceit or strict fraud in the legal sense, but rather to the broader category of equitable fraud or constructive fraud. . . . Fraud in this wider sense refers to transactions falling short of deceit but where the Court is of the opinion that it is unconscientious for a person to avail himself of the advantage obtained" (p. 37). Fraud in the "wider sense" of a ground for equitable relief "is so infinite in its varieties that the Courts have not attempted to define it," but " 'all kinds of unfair dealing and unconscionable conduct in matters of contract come within its ken' ": *McMaster University v. Wilchar Construction Ltd.* (1971), 22 D.L.R. (3d) 9 (Ont. H.C.), at p. 19. See also *Montreal Trust Co. v. Maley* (1992), 99 D.L.R. (4th) 257 (Sask. C.A.), *per* Wakeling J.A., *Alampi v. Swartz* (1964), 43 D.L.R. (2d) 11 (Ont. C.A.), *Stepps Investments Ltd. v. Security Capital Corp.* (1976), 73 D.L.R. (3d) 351 (Ont. H.C.), *per* Grange J. (as he then was), at pp. 362-363, and Waddams, *supra*, at para. 342.

40 The third hurdle is that Sylvan (Bell) must show "the precise form" in which the written instrument can be made to express the prior intention (*Hart*, *supra*, *per* Duff J., at p. 630). This requirement closes the "floodgates" to those who would invite the court to speculate about the parties' unexpressed intentions, or impose what in hindsight seems to be a sensible arrangement that the parties might have made but did not. The court's equitable jurisdiction is limited to putting into words that - and only that - which the parties had already orally agreed to.

41 The fourth hurdle is that all of the foregoing must be established by proof which this Court has variously described as "beyond reasonable doubt" ("*M. F. Whalen*" *(The)*, *supra*, at p. 127), or "evidence which leaves no 'fair and reasonable doubt' " (*Hart*, *supra*, at p. 630), or "convincing proof" or "more than sufficient evidence" (*Augdome Corp. v. Gray* (1974), [1975] 2 S.C.R. 354 (S.C.C.), at pp. 371-372). The modern approach, I think, is captured by the expression "convincing proof," i.e., proof that may fall well short of the criminal standard, but which goes beyond the sort of proof that only reluctantly and with hesitation scrapes over the low end of the civil "more probable than not" standard.

42 Some critics argue that anything more demanding than the ordinary civil standard of proof is unnecessary (e.g., Waddams, *supra*, at para. 343), but, again, the objective is to promote the utility of written agreements by closing the "floodgate" against marginal cases that dilute what are rightly seen to be demanding preconditions to rectification.

43 It was formerly held that it was not sufficient if the evidence merely comes from the party seeking rectification. In "*M. F. Whalen*" *(The)*, *supra*, Duff J. (as he then was) said, at p. 127, "[s]uch parol evidence must be adequately supported by documentary evidence and by considerations arising from the conduct of the parties." Modern practice has moved away from insistence on documentary corroboration (Waddams, *supra*, at para. 337, Fridman, *supra*, at p. 879). In some situations, documentary corroboration is simply not available, but if the parol evidence is corroborated by the conduct of the parties or other proof, rectification may, in the discretion of the Court, be available.

44 It is convenient at this point to deal with the trial judge's findings in relation to these traditional requirements. I will then turn to the appellants' proposed fifth precondition - due diligence on the part of the plaintiff.

(1) The Existence and Content of the Prior Oral Agreement

45 The appellants' principal argument against rectification is that the alleged prior oral agreement is void for uncertainty. Reliance is placed on *I.C.R.V. Holdings Ltd. v. Tri-Par Holdings Ltd.* (1994), 53 B.C.A.C. 72 (B.C. C.A.), where rectification of an agreement to purchase a recreational vehicle park was refused because, *per* Finch J.A. (now C.J.B.C.), at para. 7, the parties never agreed on "the precise location of the eastern boundary," and *Gordeyko v. Edmonton (City)* (1986), 45 Alta. L.R. (2d) 201 (Alta. Q.B.), where Stratton J. (as he then was) found the evidence uncertain about a notice period envisaged by the prior oral agreement. See also *Kerr v. Cunard* (1914), 16 D.L.R. 662 (N.B. S.C.). Appellants' counsel quotes Lord Denning's "pithy" observation that: "[a] mistake made by one party to the knowledge of the other is a ground for avoiding a contract, but not for making one" (*Byrnlea Property Investments Ltd. v. Ramsay*, [1969] 2 Q.B. 253 (Eng. C.A.), at p. 265).

46 I agree with the appellants that on this point the trial judge's reasons are somewhat unsatisfactory, but this appears to be because the "uncertainty" argument now made against rectification was not before him. The issue of uncertainty of subject matter was raised neither in the pleadings nor at trial. The trial judge directed his reasons to the points that he believed were in controversy. As to the appellants' new arguments, one may echo the words of James V.C. in *Rumble v. Heygate* (1870), 18 W.R. 749 (Eng. Ch.), who said, at p. 750, that the objections to the agreement in that case on the basis of uncertainty of quantity of land and of its site "are mere shadows which vanish when examined by the light of common sense."

47 The Court should attempt to uphold the parties' bargain where the terms can be ascertained with a reasonable level of comfort, i.e., convincing proof. Here the trial judge predicated his award of compensatory damages on the finding that the optioned land could accommodate 58 single family houses located along the 480 yard length of the 18th fairway. There is no argument about the 480 yards. O'Connor himself plucked the 480 figure from the length of play listed on the Sylvan Lake Golf Club score card. O'Connor's number for the width of the development (110) may also be accepted. The issue is whether the number was intended to express yards or feet. The trial judge appears to have concluded that the dispute about the depth of the residential development (which is all that divided the parties) came down to a simple choice between Bell's version (Plan A) and O'Connor's version (Plan B). Both plans were predicated on the length of the 18th fairway, namely, 480 yards. Plan B, which O'Connor had described in the document, contemplated a single row of houses on a development plan 110 *feet* deep. Bell's Plan A was based on two rows of housing separated by a road allowance, in a configuration similar to that shown in the aerial photo of the Bayview development discussed by Bell and O'Connor at their December 16-17 meeting. Plan A called for a depth of about 110 *yards*. If Plan B's 110-*foot* depth is tripled to 110 *yards*, the acreage under option would be roughly tripled from about 3.6 acres (Plan B) to about 10.8 acres (Plan A), which accommodates the 58 lots plus the standard municipal road allowance. The problem in *I.C.R.V. Holdings Ltd., supra*, was that the parties never agreed on the boundary. Here the trial judge concluded that there *was* agreement even though the parties did not express themselves to each other in lawyerly language. This not infrequently happens: *Bloom v. Averbach*, [1927] S.C.R. 615 (S.C.C.), per Lamont J., at p. 621:

> It is suggested that had the letters been handed to a lawyer to prepare a formal contract therefrom, he would not have been able to determine what assets were to be included in the term "building, machinery and fixtures," or what were to be covered by "stock, etc." It may be that he would not, but that is not the test. *The test is, did the parties themselves clearly understand what was comprised in each. In other words were their minds* ad idem *as to these expressions*? [Emphasis added.]

48 The trial judge thus found that the parties had made a verbal agreement with reference to a residential development along the 18th hole. It was more than an agreement to agree. He concluded that there was a definite project in a definite location to which O'Connor and Bell had given their definite assent.

49 Although the parties did not discuss a metes and bounds description, they were working on a defined development proposal. O'Connor cannot complain if the numbers he inserted in clause 18 (110 x 480) are accepted and confirmed. The issue, then, is the error created by his apparently duplicitous substitution of feet for yards in one dimension. We know the 480 must be yards because it measures the 18th fairway. If the 110 is converted from feet to yards, symmetry is achieved, certainty is preserved and Bell's position is vindicated.

(2) Fraud or Conduct Equivalent to Fraud

50 The notion of "*equivalent* to fraud," as distinguished from fraud itself, is often utilized where "the court is unwilling to go so far as to find actual knowledge on the side of the party seeking enforcement" (Waddams, *supra*, at para. 342). The trial judge had no such hesitation in this case. He characterized O'Connor's actions as "fraudulent, dishonest and deceitful" (para. 114).

51 The trial judge was persuaded not only of the terms of the prior oral agreement and of Bell's mistake but "beyond any reasonable doubt" of O'Connor's knowledge of that mistake. He states (at para. 79):

> This court is satisfied beyond any reasonable doubt that O'Connor knew of Bell's mistake and he chose to permit Bell to sign it in the mistaken belief that it represented the verbal agreement. He did so with the full intention that he would in the future rely on the terms of the Agreement to thwart or reduce any plan by Bell to develop an increased area of the golf course for residential development.

52 O'Connor thus fraudulently misrepresented the written document as accurately reflecting the terms of the prior oral contract. He knew that Bell would not sign an agreement without the option for sufficient land to create the "Bayview" layout development with two rows of housing as specified in the prior oral contract. O'Connor therefore knew when Bell signed the document that he had not detected the substitution of 110 feet for 110 yards. O'Connor knowingly snapped at Bell's mistake "to thwart or reduce any plan by Bell to develop an increased area of the golf course for residential development." Bell's loss would be O'Connor's gain, as O'Connor (Performance) would come into sole ownership of the optioned land as of December 31, 1994.

53 Although on occasion the trial judge describes O'Connor's conduct as "equivalent to fraud," and elsewhere he describes it as actual fraud, his reasons taken as a whole can only be characterized as a finding of actual fraud.

(3) Precise Terms of Rectification

54 It follows from the foregoing that "the precise form" in which the written document can be made to conform to the oral agreement would be simply to change the word "feet" in the phrase "one hundred and ten (110) *feet* in width" to "yards."

(4) Existence of "Convincing Proof"

55 The trial judge made his key findings in respect of the prior oral agreement, Bell's unilateral mistake and O'Connor's knowledge of that mistake to a standard of "beyond any reasonable doubt."

56 He also found that Bell's version of the verbal agreement was sufficiently corroborated on significant points by other witnesses (including his wife, his former partner, his lawyer and, subsequently, the development consultants), and documents (including his lawyer's notes and the plan of the Bayview Golf Course development discussed in mid-December 1989).

D. Bell's Lack of Due Diligence

57 The appellants seek, in effect, to add a fifth hurdle (or condition precedent) to the availability of rectification. A plaintiff, they say, should be denied such a remedy unless the error in the written document could not have been discovered with due diligence.

58 O'Connor says that Bell's failure to read clause 18 and note the mixture of yards and feet should be fatal to his claim because the Court ought not to assist businesspersons who are negligent in protecting their own interests. Alternatively, the effective cause of Bell's loss is not the fraudulent document but Bell's failure to detect the fraud when he had an opportunity to do so.

59 I agree that Bell, an experienced businessman, ought to have examined the text of clause 18 before signing the document. The terms of clause 18 were clear on their face (even though many readers might have misread a description of land that mixed units of measurement as clause 18 did here). He had time to review the document with his lawyer. He did so. Changes were requested. He did not catch the substitution of 110 feet for 110 yards; indeed, he says he did not read clause 18 at all.

60 The trial judge, at para. 76, accepted the evidence of Bell's lawyer, who admitted that he had not directed his mind to the limitations of the size of the development parcel found in clause 18, nor had he made any note of bringing those to Bell's attention, which would have been his normal practice.

> He could offer no explanation for why he had not done so other than the fact that his focus on receipt of the Agreement signed by Bell was to ensure the completion and registration of documentation to facilitate the closing of [the purchase] on or before December 31, 1989. This court accepts the evidence offered by Mr. Hancock and that of Bell that they at no time discussed the description of property contained in clause 18.

61 It is undoubtedly true that courts ought to hold commercial entities to a reasonable level of due diligence in documenting their transactions. Otherwise, written agreements will lose their utility and commercial life will suffer. Rectification should not become a belated substitute for due diligence.

62 On the other hand, most cases of unilateral mistake involve a degree of carelessness on the part of the plaintiff. A diligent reading of the written document would generally have disclosed the error that the plaintiff, after the fact, seeks to have corrected. The mistaken party will often have failed to read the document entirely, or may have read it too hastily or without parsing each word. As the American *Restatement of the Law, Second: Contracts (2d)* (St. Paul, Minn.: American Law Institute Publishers, 1981), points out in its commentary under s. 157 ("Effect of Fault of Party Seeking Relief"), "since a party can often avoid a mistake by the exercise of such care, the availability of relief would be severely circumscribed if he were to be barred by his negligence." Comment B discusses "failure to read writing." "Generally, one who assents to a writing is presumed to know its contents and cannot escape being bound by its terms merely by contending that he did not read them; his assent is deemed to cover unknown as well as known terms." But this proposition is qualified by that Comment's further statement that the "exceptional rule" in s. 157 (which permits rectification or "reformation" of the contract) applies only where there has been an agreement that preceded the writing. "In such a case, a party's negligence in failing to read the writing does not preclude reformation if the writing does not correctly express the prior agreement."

63 One reason why the defence of contributory negligence or want of due diligence is not persuasive in a rectification case is because the plaintiff seeks no more than enforcement of the prior oral agreement to which the defendant has already bound itself.

64 The commentary in the American *Restatement* is consistent with the Canadian case law. For example, in *Beverley Motel (1972) Ltd. v. Klyne Properties Ltd.* (1981), 126 D.L.R. (3d) 757 (B.C. S.C.), the vendor signed documents, already signed by the purchaser, in the office of the purchaser's solicitor that conveyed two lots, the single lot (with a motel) that the vendor had offered for sale and the adjacent residentially zoned vacant lot. Of that group of individuals, only the purchaser noted the error (on the day of signing) and he was "pleased and surprised" another lot had been included. He

snapped at the offer but he had played no role in inducing the mistake. Gould J. conceded (at pp. 758-759), "[i]t is quite true that if they [the three shareholders of the vendor] had read the legal description in the documents with any care, they would have caught the error. Obviously they did not so read the legal description, and that is understandable, although careless, because they were with their own solicitor, present in the purchaser's solicitor's office, and both solicitors were obviously giving the impression that the final documents were in order and ready for signature." Gould J. ordered that the second lot be conveyed back to the original vendor because it was "unfair, unjust or unconscionable" (p. 760) for the purchaser "to hold the legal advantage he ha[d] gained" (p. 759). Gould J. acknowledged that the presence of a solicitor can help explain why a party might not himself read the written document. In the present case, Bell left the documentation up to the lawyers without appreciating that he had given his lawyer insufficient information to check O'Connor's figures. He had, at that time, no reason to question O'Connor's integrity.

65 If want of due diligence had been a good defence to rectification, relief would likely have been refused in *Big Quill Resources Inc. v. Potash Corp. of Saskatchewan Inc.* (2001), 203 Sask. R. 298, 2001 SKCA 31 (Sask. C.A.), *Stepps Investments Ltd.*, *supra*, *per* Grange J., at p. 362, *Prince Albert Credit Union Ltd. v. Diehl*, [1987] 4 W.W.R. 419 (Sask. Q.B.), *Montreal Trust Co.*, *supra*, at p. 262, *Windjammer Homes Inc. v. Generation Enterprises* (1989), 43 B.L.R. 315 (B.C. S.C.).

E. Discretionary Relief

66 I conclude, therefore, that due diligence on the part of the plaintiff is not a condition precedent to rectification. However, it should be added at once that rectification is an equitable remedy and its award is in the discretion of the court. The conduct of the plaintiff is relevant to the exercise of that discretion. In a case where the court concludes that it would be unjust to impose on a defendant a liability that ought more properly to be attributed to the plaintiff's negligence, rectification may be denied. That was not the case here.

F. Fraud

67 There is, on the facts of this case, a more fundamental reason why the appellants' complaint about Bell's lack of due diligence provides no defence. O'Connor did more than "snap" at a business partner's mistake. O'Connor undertook as part of the verbal agreement to have a document prepared that set out its terms. According to the trial judge, he not only breached that term, it became part of his fraudulent scheme to have the document wrongly state the terms of the option, to fraudulently misrepresent to Bell that it did accurately set out their verbal agreement, to allow Bell to sign it when O'Connor knew Bell was mistaken in doing so, then to delay any response to Bell's development proposals (and thus bring the error to Bell's attention) until it was almost too late for the development to proceed. O'Connor admitted providing his lawyer with the erroneous metes and bounds description in clause 18. It should not, I think, lie in his mouth to say that he should not be responsible for what followed because his fraud was so obvious that it ought to have been detected.

68 "[F]raud 'unravels everything' ": *Farah v. Barki*, [1955] S.C.R. 107 (S.C.C.), at p. 115 (Kellock J. quoting Farwell J. in *May v. Platt*, [1900] 1 Ch. 616 (Eng. Ch. Div.), at p. 623).

69 The appellants' concept of a due diligence defence in a fraud case was rejected over 125 years ago by Lord Chelmsford L.C., who said, "when once it is established that there has been any fraudulent misrepresentation or wilful concealment by which a person has been induced to enter into a contract, it is no answer to his claim to be relieved from it to tell him that he might have known the truth by proper inquiry. He has a right to retort upon his objector, 'You, at least, who have stated what is untrue, or have concealed the truth, for the purpose of drawing me into a contract, cannot accuse me of want of caution because I relied implicitly upon your fairness and honesty' ": *Central Railway Co. of Venezuela v. Kisch* (1867), L.R. 2 H.L. 99 (U.K. H.L.), at pp. 120-121.

70 Lord Chelmsford's strictures were quoted and applied by Southin J. (as she then was) in *United Services Funds (Trustees of) v. Richardson Greenshields of Canada Ltd.* (1988), 22 B.C.L.R. (2d) 322 (B.C. S.C.), where she observed that "[c]arelessness on the part of the victim has never been a defence to an action for fraud" (p. 335).

> Once the plaintiff knows of the fraud he must mitigate his loss but until he knows of it, in my view, no issue of reasonable care or anything resembling it arises at law.
>
> And, in my opinion, a good thing, too. There may be greater damages to civilized society than endemic dishonesty. But I can think of nothing which will contribute to dishonesty more than a rule of law which requires us all to be on perpetual guard against rogues lest we be faced with a defence of "Ha, ha, your own fault I fool you." Such a defence should not be countenanced from a rogue. (p. 336)

See also *Dalon v. Legal Services Society (British Columbia)* (1995), 10 C.C.E.L. (2d) 89 (B.C. S.C.). To the same effect is George Spencer Bower and Alexander Kingcome Turner, *The Law of Actionable Misrepresentation*, 3rd ed. (London: Butterworths, 1974), at p. 218:

> A man who has told even an innocent untruth, by which he has induced another to alter his position, - much more one who has fraudulently lied with that object and result, - has debarred himself from ever complaining in a court of justice, any more than he could in a court of morals, that the representee acted on the faith of his misstatement in the manner in which he, the representor, intended that he should. He can never be heard to resent the fact that another believed the lie that was told for the very purpose of inspiring that belief, or plead as an excuse that, if the representee had not been such a fool as to trust such a knave, no harm would have been done.

71 The appellants having failed to establish that due diligence on the part of the plaintiff is a precondition to rectification, or to shake the trial judge's findings with respect to the traditional preconditions discussed above, their appeal on the rectification issues must be rejected.

G. Damages in Lieu of Rectification

72 The trial judge awarded $620,100 in compensatory damages representing the loss of profit on a fully built residential development on the 18th fairway. The appellants argue that damages should be limited to the difference between the market value of the land and the option price of $400,000. They say compensatory damages should not include the "reasonably expected profit" from a 58-lot housing development.

73 The finding of fact is, however, that the parties specifically contemplated (even on O'Connor's evidence) that the optioned land would be put to the use of residential housing. Damages for breach of the contract, as rectified, therefore must include losses flowing from the special circumstances known to the parties at the time they made their contract: *Brown & Root Ltd. v. Chimo Shipping Ltd.*, [1967] S.C.R. 642 (S.C.C.), at p. 648, *General Securities Ltd. v. Don Ingram Ltd.*, [1940] S.C.R. 670 (S.C.C.), *Australian Newsprint Mills Ltd. v. Canadian Union Line Ltd.*, [1954] S.C.R. 307 (S.C.C.), *Corbin v. Thompson* (1907), 39 S.C.R. 575 (S.C.C.), *Baud Corp., N.V. v. Brook* (1978), [1979] 1 S.C.R. 633 (S.C.C.), at p. 655. In *New Horizon Investments Ltd. v. Montroyal Estates Ltd.* (1982), 26 R.P.R. 268 (B.C. S.C.), Nemetz C.J.B.C. observed, at pp. 272-273:

> [T]he plaintiff's damages should be assessed by reference to the profits which both parties contemplated the plaintiff would make but for the breach. It is not necessary that this contemplation include a precise pre-estimate or calculation of these losses, only a " . . . contemplation of circumstances which embrace the head or type of damage in question".

74 The appellants then contend that even if the trial judge selected the correct measure of damages, he ought to have applied a higher discount for contingencies, particularly the contingencies that (1) Sylvan (Bell) lacked the financial resources to exercise the option and fund the project, and (2) the project could not, in any event, have been completed by the end of 1994, as required. In essence, they argue that in assessing damages, the Court must discount the value of the chance of profit by the improbability of its occurrence, and call in aid the observation of Crocket J. in *Hyman v. Kinkel*, [1939] S.C.R. 364 (S.C.C.), at p. 383:

> For my part, I can find no authority . . . justifying any court in awarding any more than a nominal sum as damages for the loss of a mere chance of possible benefit except upon evidence proving that there was some reasonable probability of the plaintiff realizing therefrom an advantage of some real substantial monetary value.

75 It is at this point, I think, that the appellants' argument runs afoul of the rule against raising new fact-based issues on appeal. The trial judge has found as a fact that the respondent contracted for the opportunity to build a residential development on about 10.9 acres of prime land. It was wrongfully deprived of that opportunity. The trial judge set out to assess the value of that lost opportunity (which was, of course, potentially worth considerably less than a certainty). The appellants' trial counsel took little issue with the damages claim as advanced by Sylvan, and did not adduce much of an evidentiary record to the contrary, whether by calling his own witnesses, or through cross-examination of the respondent's witnesses, to challenge significantly the expert evidence of Trouth and others. Trouth may have been overly optimistic and his figures generous, but his evidence was uncontradicted.

76 The Alberta Court of Appeal characterized the compensatory award as "substantial and generous" (para. 29) but concluded that: "Despite our reservations, we are not prepared to interfere with the award of damages in this case" (para. 27). In the absence of an error of principle, or a factual record that supports the appellants' criticisms, this Court ought not to interfere with the concurrent findings in the Alberta courts on the amount of compensatory damages.

H. Should the award of punitive damages be restored?

77 The respondent in its cross-appeal seeks restoration of the $200,000 award of punitive damages disallowed by the Alberta Court of Appeal. Principles concerning the award and assessment of punitive damages were canvassed at the hearing of this appeal, heard the same day as *Whiten*, *supra*, reasons in which are released concurrently.

78 It is sufficient to apply the principles developed in *Whiten* without repeating the underlying analysis.

79 Punitive damages are awarded against a defendant in exceptional cases for "malicious, oppressive and high-handed" misconduct that "offends the court's sense of decency." The test thus limits the award to misconduct that represents a marked departure from ordinary standards of decent behaviour: *Whiten*, *supra*, at para. 36, and *Hill v. Church of Scientology of Toronto*, [1995] 2 S.C.R. 1130 (S.C.C.), at para. 196.

80 The misconduct found against O'Connor was his contemptuous disregard for Bell's rights under the verbal agreement of December 1989, together with his subsequent use of the written document (which he knew misstated their verbal agreement) leading up to and including court proceedings filed January 4, 1995, to obtain possession of the golf course property and thereby to destroy the value of Bell's option to develop the agreed-upon residential project.

81 Torts such as deceit or fraud already incorporate a type of misconduct that to some extent "offends the court's sense of decency" and which "represents a marked departure from ordinary standards of decent behaviour," yet not all fraud cases lead to an award of punitive damages.

82 O'Connor's fraud was a condition precedent to Bell's successful claim to rectification, for which his company will now receive compensatory damages of $620,100. Payment of $620,100 hurts. The question is whether *more* punishment is rationally required by way of retribution, deterrence or denunciation (*Whiten*, *supra*, at para. 43).

83 *Whiten* emphasizes that defendants should have "advance notice of the charge sufficient to allow them to consider the scope of their jeopardy as well as the opportunity to respond to it" (*Whiten*, *supra*, at para. 86). Here, punitive damages in the sum of $1,020,100 were expressly sought in the Amended Amended Statement of Claim and the basis for the claim was "disgorgement of the profits the Defendants will enjoy as a result of the [Plaintiff's] unilateral mistake." The trial judge, as stated, awarded $200,000 in punitive damages.

84 The applicable standard of appellate review for "rationality" was articulated by Cory J. in *Hill*, *supra*, at para. 197:

> Unlike compensatory damages, punitive damages are not at large. Consequently, courts have a much greater scope and discretion on appeal. The appellate review should be based upon the court's estimation as to whether the punitive damages serve a rational purpose. In other words, was the misconduct of the defendant so outrageous that punitive damages were rationally required to act as deterrence?

85 *Whiten* affirms that "[t]he 'rationality' test applies both to the question of whether an award of punitive damages should be made at all, as well as to the question of its quantum" (para. 101).

86 I agree with the Alberta Court of Appeal that the award of punitive damages in this case does not serve a rational purpose.

87 O'Connor's fraud was, of course, reprehensible. Indeed, fraud is generally reprehensible, but only in exceptional cases does it attract punitive damages. In this case, the trial judge, at para. 109, thought punishment above and beyond the payment of generous compensatory damages was required for two reasons, namely that O'Connor's actions (1) "demand an award which will stand as an example to others" and (2) "at the same time assure that O'Connor does not unduly profit from his conduct." These are both legitimate objectives for the award of punitive damages (*Whiten*, *supra*, at paras. 43, 111). However, it must be kept in mind that an award of punitive damages is rational "if, but only if" compensatory damages do not adequately achieve the objectives of retribution, deterrence and denunciation.

88 This was a commercial relationship between two businessmen. One tried to pull a fast one on the other. There was no abuse of a dominant position. O'Connor's misconduct was planned and deliberate and he persisted in it over a period of four and a half years, but, in the end, the courts did their work and Bell obtained full compensation plus costs on a solicitor-client basis, all of which undoubtedly had a punitive effect on O'Connor. In addition, O'Connor is stigmatized with a judicial finding (now upheld by two appellate courts) that he acted in a way that was "fraudulent, dishonest and deceitful." His conduct has been soundly denounced and he has been required personally to pay a large amount of money in compensation. The respondent is unable to identify any aggravating circumstances that would not be present in almost any case of business fraud except that O'Connor was found to have behaved abominably in the conduct of the litigation. However, as stated, the trial judge excluded this consideration from the award of punitive damages because he identified it as the basis for his award of solicitor-client costs.

89 The trial judge's second reason for punitive damages was to ensure that O'Connor "[did] not unduly profit from his conduct" (para. 109). But in fact O'Connor did not profit at all from his misconduct. The source of his development profits was the prior oral contract. Whatever Performance (O'Connor) made after paying $620,100 compensatory damages to the respondent rightfully belonged to them under the terms of the (rectified) agreement. As discussed earlier, the verbal agreement of December 1989 contemplated that after five years, O'Connor's company, Performance, would acquire the golf club lands (minus the optioned lands if the option had been exercised) to develop as it wished for its own account. While on the whole O'Connor's conduct in this matter was found to be reprehensible, his behaviour also had some redeeming qualities. Early on in the project, for example, O'Connor picked up Bell's share of mortgage interest when Bell was not able to afford to contribute the amount that he had agreed to pay. The conflict between Bell and O'Connor should not be caricatured as a battle between good and evil.

90 It may be true, as the trial judge found, that O'Connor's profits on the balance of lands *not* subject to the option will "recover all or more of the amount of damage for loss of profit awarded against him in favour of Bell" (para. 109), but, with respect, that is not a rational reason to punish O'Connor further. Those profits are not the fruit of misconduct directed at Bell.

91 Finally, the assessment of $200,000 coincides with the payment that Sylvan (Bell) was obliged to pay in order to exercise the option, and which the trial judge properly took into account in his assessment of compensatory damages. This figure has no rational relationship to the appellants' potential development profits on the balance of the golf course

land, on which there was no evidence. Moreover, it is a payment that the appellants, under the rectified agreement, were entitled to keep.

92 As pointed out in *Whiten*, *supra*, at paras. 98 and 100, and *Hill*, *supra*, at para. 197, punitive damages are not "at large," and both the award and the assessment of quantum must meet the test of rationality. In this case, with respect, neither the punitive damages award nor the $200,000 assessment survives that test.

IV. Conclusion

93 I would therefore dismiss the appeal and cross-appeal both with costs on a party and party basis.

LeBel J.:

94 Subject to my comments on punitive damages in *Whiten v. Pilot Insurance Co.*, 2002 SCC 18 (S.C.C.), I agree with Binnie J.'s reasons. I would dispose of the appeal and cross-appeal as he suggests. Rectification of the contract was properly ordered, but punitive damages would fulfil no rational purpose in this case.

Appeal dismissed; cross-appeal dismissed.

Pourvoi rejeté; pourvoi incident rejeté.

Footnotes

* Corrigendum to para. 70: the D.L.R. cite was replaced with the B.C.L.R. cite, with the consequent changes to page references being made in the quotation.

1 Davies Ward Phillips & Vineberg, LLP

TAB 18

2015 ONCA 681
Ontario Court of Appeal

Nortel Networks Corp., Re

2015 CarswellOnt 15461, 2015 ONCA 681, 127 O.R. (3d) 641, 259 A.C.W.S. (3d) 15, 32 C.B.R. (6th) 21, 340 O.A.C. 234, 391 D.L.R. (4th) 283

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

In the Matter of a Plan of Compromise or Arrangement of Nortel Networks Corporation, Nortel Networks Limited, Nortel Networks Global Corporation, Nortel Networks International Corporation and Nortel Networks Technology Corporation

Janet Simmons, E.E. Gillese, Paul Rouleau JJ.A.

Heard: April 29, 2015
Judgment: October 13, 2015
Docket: CA C59703

Proceedings: affirming *Nortel Networks Corp., Re* (2014), 121 O.R. (3d) 228, 2014 ONSC 4777, 2014 CarswellOnt 17193 (Ont. S.C.J. [Commercial List])

Counsel: Richard B. Swan, S. Richard Orzy, Gavin H. Finlayson, for Appellant, Ad Hoc Group of Bondholders
Andrew Kent, Brett Harrison, for Respondent, Bank of New York Mellon
Edmond Lamek, for Respondent, Law Debenture Trust Company of New York
Benjamin Zarnett, Graham D. Smith, for Monitor and Respondent, Canadian Debtors
Kenneth D. Kraft, John J. Salmas, for Respondent, Wilmington Trust, National Association
Kenneth T. Rosenberg, Ari N. Kaplan, for Respondent, Canadian Creditors' Committee
Tracy Wynne, for Joint Administrators (EMEA)
Scott A. Bomhof, Adam M. Slavens, for Nortel Networks Inc./U.S. Debtors

Subject: Civil Practice and Procedure; Insolvency

Headnote

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

Groups of companies were subject to proceedings under Companies' Creditors Arrangement Act (CCAA) — Appellants were ad hoc group of bondholders holding crossover bonds that were issued or guaranteed by Canadian entities of companies and they provided for continuing accrual of interest until payment — Holders of crossover bonds filed claims for principal and pre-filing interest in amount of US$4.092 billion and they also claimed they were entitled to post-filing interest under terms of crossover bonds — In context of joint allocation trial, CCAA judge found that the common law "interest stops rule" applied in context of CCAA and holders of crossover bond claims were not legally entitled to claim or receive any amounts under relevant indentures above and beyond outstanding principal debt and pre-petition interest — Bondholders' appealed — Appeal dismissed — Main purposes of interest stops rule were fairness to creditors and achieving orderly administration of insolvent debtor's estate — Interest stops rule had been consistently applied in bankruptcy and winding-up proceedings — While there were differences between CCAA and other insolvency schemes, same principles supporting conclusion that interest stops rule was necessary in bankruptcy and insolvency proceedings, namely, fair treatment of creditors and orderly administration of insolvent debtor's estate, applied with equal force to CCAA proceedings — As interest stops rule applied upon

bankruptcy under Bankruptcy and Insolvency Act, it should also apply in CCAA proceedings unless rule was ousted by CCAA, which it was not — If interest stops rule did not apply in CCAA proceedings then creditors who did not have contractual right to post-filing interest would have skewed incentives against reorganization under CCAA — CCAA created conditions for preserving status quo and if post filing interest was available to only one set of creditors then status quo was not preserved — If interest stops rule did not apply to CCAA proceedings then key objective of CCAA, to facilitate restructuring of corporations through flexibility and creativity, might be undermined due to uneven entitlement to interest that might be created — Principle of fairness supported application of interest stops rule — Interest stops rule was not contrary to established CCAA practice and it did not prevent CCAA plan from providing for post-filing interest — There were rational reasons for adopting interest stops rule in CCAA context.

Bankruptcy and insolvency --- Companies' Creditors Arrangement Act — Appeals

Groups of companies were subject to proceedings under Companies' Creditors Arrangement Act (CCAA) — Appellants were ad hoc group of bondholders holding crossover bonds that were issued or guaranteed by Canadian entities of companies and they provided for continuing accrual of interest until payment — Holders of crossover bonds filed claims for principal and pre-filing interest in amount of US$4.092 billion and they also claimed they were entitled to post-filing interest under terms of crossover bonds — In context of joint allocation trial, CCAA judge found that the common law "interest stops rule" applied in context of CCAA and holders of crossover bond claims were not legally entitled to claim or receive any amounts under relevant indentures above and beyond outstanding principal debt and pre-petition interest — Bondholders' appealed — Appeal dismissed — Main purposes of interest stops rule were fairness to creditors and achieving orderly administration of insolvent debtor's estate — Interest stops rule had been consistently applied in bankruptcy and winding-up proceedings — While there were differences between CCAA and other insolvency schemes, same principles supporting conclusion that interest stops rule was necessary in bankruptcy and insolvency proceedings, namely, fair treatment of creditors and orderly administration of insolvent debtor's estate, applied with equal force to CCAA proceedings — As interest stops rule applied upon bankruptcy under Bankruptcy and Insolvency Act, it should also apply in CCAA proceedings unless rule was ousted by CCAA, which it was not — If interest stops rule did not apply in CCAA proceedings then creditors who did not have contractual right to post-filing interest would have skewed incentives against reorganization under CCAA — CCAA created conditions for preserving status quo and if post filing interest was available to only one set of creditors then status quo was not preserved — If interest stops rule did not apply to CCAA proceedings then key objective of CCAA, to facilitate restructuring of corporations through flexibility and creativity, might be undermined due to uneven entitlement to interest that might be created — Principle of fairness supported application of interest stops rule — Interest stops rule was not contrary to established CCAA practice and it did not prevent CCAA plan from providing for post-filing interest — There were rational reasons for adopting interest stops rule in CCAA context.

The group of companies were subject to proceedings under the Companies' Creditors Arrangement Act (CCAA). The appellants were an ad hoc group of bondholders holding crossover bonds, which were unsecured bonds that were issued or guaranteed by the Canadian entities of the companies. The indentures provided for the continuing accrual of interest until payment, at contractually specified interest rates, as well as other post-filing payment obligations. Other claimants, including pensioners and former employees, did not have a provision for interest on amounts owing. The holders of the crossover bonds filed claims for principal and pre-filing interest in the amount of US$4.092 billion. They also claimed they were entitled to post-filing interest and related claims under the terms of the crossover bonds of approximately US$1.6 billion.

In the context of a joint allocation trial, the CCAA judge found that the common law "interest stops rule" applied in the context of the CCAA. The CCAA judge found that the holders of the crossover bond claims were not legally entitled to claim or receive any amounts under the relevant indentures above and beyond the outstanding principal debt and pre-petition interest, namely, above and beyond US$4.092 billion. The crossover bondholders appealed.

Held: The appeal was dismissed.

Per Rouleau J.A. (Simmons and Gillese JJ.A. concurring): The pari passu principle provided that the assets of an insolvent debtor were to be distributed amongst classes of creditors rateably and equally as those assets were found at the date of insolvency. The pari passu principle was the foremost principle in insolvency law. The pari passu principle was grounded in the need to treat all creditors fairly and to ensure an orderly distribution of assets. A necessary corollary of the pari passu principle was the interest stops rule. The interest stops rule was a fundamental tenant of insolvency law. Absent the interest stops rule, the fair and orderly distribution sought by the pari passu principle could not be achieved. The main purposes behind the interest stops rule were fairness to creditors and to achieve the orderly administration of an insolvent debtor's estate. The interest stops rule had been consistently applied in bankruptcy and winding-up proceedings.

There were differences between the CCAA and other insolvency schemes. However, the same principles supporting the conclusion that the interest stops rule was necessary in bankruptcy and insolvency proceedings, namely, the fair treatment of creditors and the orderly administration of an insolvent debtor's estate, applied with equal force to CCAA proceedings. The CCAA was an integrated insolvency regime, which included the Bankruptcy and Insolvency Act (Act). In keeping with the idea of harmonization, as the interest stops rule applied upon bankruptcy under the Act, it should also apply in CCAA proceedings unless the rule was ousted by the CCAA, which it was not. If the interest stops rule did not apply in CCAA proceedings then the creditors who did not have a contractual right to post-filing interest would have skewed incentives against reorganization under the CCAA. Such creditors would have an incentive to proceed under the Act or the Winding-up and Restructuring Act where the interest stops rule applied to prevent creditors who had a contractual right to interest from improving their proportionate claim against the debtor at the expense of other creditors. The CCAA created conditions for preserving the status quo and if post filing interest was available to only one set of creditors then the status quo was not preserved.

If the interest stops rule did not to apply CCAA proceedings then the key objective of the CCAA, to facilitate the restructuring of corporations through flexibility and creativity, might be undermined due to the uneven entitlement to interest that might be created. Creditors who had an entitlement to post-filing interest might be less motivated to compromise. The ability to find a compromise acceptable to all creditors would be more challenging if the amount of a creditor's legal entitlement was constantly shifting as post-interest accrued. The principle of fairness supported the application of the interest stops rule. The interest stops rule was not contrary to established CCAA practice and it did not prevent a CCAA plan from providing for post-filing interest. There were rational reasons for adopting the interest stops rule in the CCAA context.

The interest stops rule did not preclude the payment of post-filing interest under a plan of compromise or arrangement. Nothing in the CCAA judge's reasons prevented the bondholders from seeking and obtaining post-filing interest through a negotiated plan.

Table of Authorities

Cases considered by *Paul Rouleau J.A.*:

Canada (Attorney General) v. Confederation Life Insurance Co. (2001), 2001 CarswellOnt 2299, [2001] O.T.C. 486 (Ont. S.C.J. [Commercial List]) — considered

Canada 3000 Inc., Re (2002), 2002 CarswellOnt 1598, 33 C.B.R. (4th) 184, 5 P.P.S.A.C. (3d) 272, [2002] O.T.C. 310 (Ont. S.C.J.) — followed

Canada 3000 Inc., Re (2004), 2004 CarswellOnt 149, 235 D.L.R. (4th) 618, 183 O.A.C. 201, (sub nom. *Greater Toronto Airports Authority v. International Lease Finance Corp.)* 69 O.R. (3d) 1, 3 C.B.R. (5th) 207 (Ont. C.A.) — referred to

Humber Ironworks & Shipbuilding Co., Re (1869), 4 Ch. App. 643 (Eng. Ch. Div.) — considered

Indalex Ltd., Re (2013), 2013 SCC 6, 2013 CarswellOnt 733, 2013 CarswellOnt 734, D.T.E. 2013T-97, 96 C.B.R. (5th) 171, 354 D.L.R. (4th) 581, 20 P.P.S.A.C. (3d) 1, 439 N.R. 235, 301 O.A.C. 1, 8 B.L.R. (5th) 1, (sub nom. *Sun Indalex Finance LLC v. United Steelworkers)* [2013] 1 S.C.R. 271, 2 C.C.P.B. (2nd) 1 (S.C.C.) — followed

NAV Canada c. Wilmington Trust Co. (2006), 2006 SCC 24, 2006 CarswellQue 4890, 2006 CarswellQue 4891, 20 C.B.R. (5th) 1, (sub nom. *Canada 3000 Inc., (Bankrupt), Re)* 349 N.R. 1, (sub nom. *Greater Toronto Airports Authority v. International Lease Finance Corp.)* 80 O.R. (3d) 558 (note), (sub nom. *Canada 3000 Inc. (Bankrupt), Re)* 212 O.A.C. 338, (sub nom. *Canada 3000 Inc., Re)* 269 D.L.R. (4th) 79, (sub nom. *Canada 3000 Inc., Re)* [2006] 1 S.C.R. 865, 10 P.P.S.A.C. (3d) 66 (S.C.C.) — followed

Nortel Networks Corp., Re (2015), 2015 ONSC 2987, 2015 CarswellOnt 7072, 27 C.B.R. (6th) 175 (Ont. S.C.J. [Commercial List]) — considered

Nortel Networks Corp., Re (2015), 2015 ONSC 2987, 2015 CarswellOnt 7072, 27 C.B.R. (6th) 175 (Ont. S.C.J. [Commercial List]) — referred to

R. v. Henry (2005), 2005 SCC 76, 2005 CarswellBC 2972, 2005 CarswellBC 2973, 33 C.R. (6th) 215, 202 C.C.C. (3d) 449, 260 D.L.R. (4th) 411, 49 B.C.L.R. (4th) 1, 219 B.C.A.C. 1, 361 W.A.C. 1, 376 A.R. 1, 360 W.A.C. 1, 136 C.R.R. (2d) 121, [2006] 4 W.W.R. 605, (sub nom. *R. c. Henry)* [2005] 3 S.C.R. 609, 342 N.R. 259 (S.C.C.) — considered

Stelco Inc., Re (2006), 2006 CarswellOnt 4857, 24 C.B.R. (5th) 59, 20 B.L.R. (4th) 286 (Ont. S.C.J. [Commercial List]) — followed

Stelco Inc., Re (2007), 2007 ONCA 483, 2007 CarswellOnt 4108, 32 B.L.R. (4th) 77, 35 C.B.R. (5th) 174, 226 O.A.C. 72 (Ont. C.A.) — referred to

Ted Leroy Trucking Ltd., Re (2010), 2010 SCC 60, 2010 CarswellBC 3419, 2010 CarswellBC 3420, 12 B.C.L.R. (5th) 1, (sub nom. *Century Services Inc. v. A.G. of Canada)* 2011 D.T.C. 5006 (Eng.), (sub nom. *Century Services Inc. v. A.G. of Canada)* 2011 G.T.C. 2006 (Eng.), [2011] 2 W.W.R. 383, 72 C.B.R. (5th) 170, 409 N.R. 201, (sub nom. *Ted LeRoy Trucking Ltd., Re)* 326 D.L.R. (4th) 577, (sub nom. *Century Services Inc. v. Canada (A.G.))* [2010] 3 S.C.R. 379, [2010] G.S.T.C. 186, (sub nom. *Leroy (Ted) Trucking Ltd., Re)* 296 B.C.A.C. 1, (sub nom. *Leroy (Ted) Trucking Ltd., Re)* 503 W.A.C. 1 (S.C.C.) — followed

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Generally — referred to

Airport Transfer (Miscellaneous Matters) Act, S.C. 1992, c. 5
Generally — referred to

s. 9 — considered

s. 9(1) — considered

Bankruptcy Code, 11 U.S.C.
Chapter 11 — referred to

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

s. 121 — considered

s. 122 — considered

Civil Air Navigation Services Commercialization Act, S.C. 1996, c. 20
Generally — referred to

s. 55 — considered

s. 56 — considered

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

Winding-up and Restructuring Act, R.S.C. 1985, c. W-11
Generally — referred to

APPEAL by bondholders from judgment reported at *Nortel Networks Corp., Re* (2014), 2014 ONSC 4777, 2014 CarswellOnt 17193, 121 O.R. (3d) 228 (Ont. S.C.J. [Commercial List]), finding interest stops rule applied in *Companies' Creditors Arrangement Act* proceedings and that bondholders were not legally entitled to claim or receive any amounts beyond outstanding principal debt and pre-petition interest.

Paul Rouleau J.A.:

A. Overview

1 This appeal represents another chapter in the Nortel proceeding under the *Companies' Creditors Arrangement Act*, R.S.C. 1985, c. C-36 ("*CCAA*"), which has been on-going since January 2009. A parallel proceeding under Chapter 11 of the United States *Bankruptcy Code* has also been on-going in Delaware since that time.

2 The *Ad Hoc* Group of Bondholders (the "appellant") brings this appeal with leave. The group represents substantial holders of "crossover bonds", which are unsecured bonds either issued or guaranteed by certain of the Canadian Nortel entities. The relevant indentures provide for the continuing accrual of interest until payment, at contractually specified interest rates, as well as other post-filing payment obligations, such a make-whole provisions and trustee fees.

3 In contrast, the claims of other claimants, such as Nortel pensioners and former employees, do not have a provision for interest on amounts owing to them.

4 Holders of the crossover bonds have filed claims for principal and pre-filing interest in the amount of US$4.092 billion against each of the Canadian and U.S. Nortel estates. They also claim they are entitled to post-filing interest and related claims under the terms of the crossover bonds. As of December 31, 2013, the amount of this claim was

approximately US$1.6 billion. The total of these two amounts represents a significant portion of the proceeds generated from the worldwide sale of Nortel's business lines and other Nortel assets, totalling approximately $7.3 billion. This latter amount is apparently not growing at any appreciable rate because of the conservative nature of the investments made with it pending the outcome of the insolvency proceedings.

5 In the context of a joint allocation trial, the *CCAA* judge directed that two issues be argued:

> 1. whether the holders of the crossover bond claims are legally entitled ... to claim or receive any amounts under the relevant indentures above and beyond the outstanding principal debt and pre-petition interest (namely, above and beyond US$4.092 billion); and
>
> 2. if it is determined that the crossover bondholders are so entitled, what additional amounts are such holders entitled to so claim and receive.

6 The *CCAA* judge answered the first question in the negative and so he did not need to answer the second question. In reaching that conclusion, he accepted that the common law "interest stops rule", which has been held to be a fundamental tenet of insolvency law, applies in the *CCAA* context. He disagreed with the appellant's submission that the Supreme Court of Canada's decision in *NAV Canada c. Wilmington Trust Co.*, 2006 SCC 24, [2006] 1 S.C.R. 865 (S.C.C.) [hereinafter *Canada 3000*], and this court's subsequent decision in *Stelco Inc., Re*, 2007 ONCA 483, 35 C.B.R. (5th) 174 (Ont. C.A.), are binding authority that the interest stops rule does not apply in the *CCAA* context.

7 On appeal, the appellant raises two related issues — whether the *CCAA* judge erred in concluding that an interest stops rule applies in *CCAA* proceedings and, if not, whether he erred in concluding that the holders of Crossover Bond Claims are not legally entitled to claim or receive any amounts under the relevant indentures above and beyond the outstanding principal debt and pre-petition interest.

8 I would dismiss the appeal. As I will explain, there are sound legal and policy reasons for applying the interest stops rule in the *CCAA* context, and as I read *Stelco Inc., Re* and *Canada 3000*, they do not preclude such a result. Nor do I see a basis for varying the order that he made.

B. Background

9 In the *CCAA* court's initial order of January 14, 2009, the Canadian Debtors [1] were directed, subject to certain exceptions, to make no payments of principal or interest on account of amounts owing by the Canadian Debtors to any of their creditors as of the filing date, unless approved by the Monitor. Further, all proceedings and enforcement processes, and all rights and remedies of any person against the Canadian Debtors were stayed absent consent of the Canadian Debtors and the Monitor, or leave of the court.

10 In accordance with a claims procedure order dated July 30, 2009, claims against the Canadian Debtors were required to be filed by a claims bar date. Under a subsequent claims resolution order dated September 16, 2010, a disputed claim could be brought before the *CCAA* court for final determination.

11 As previously noted, holders of the crossover bonds filed proofs of claim that included not only the principal amount of the debt and interest accrued to the date of insolvency but also contractual claims for interest and other amounts post-filing.

12 In May 2014, a joint allocation trial, conducted by way of video-link by the *CCAA* judge in Ontario and Judge Gross in Delaware, commenced on the issue of the allocation of the sale proceeds among the debtor estates, including the Canadian and U.S. estates. In his 2015 decision, the *CCAA* judge, citing the "fundamental tenet of insolvency law that all debts shall be paid *pari passu*" and that "all unsecured creditors receive equal treatment" held that the $7.3 billion in funds generated from the Nortel liquidation should be allocated on a *pro rata* basis as among the estates: 2015 ONSC 2987, 23 C.B.R. (6th) 249 (Ont. S.C.J. [Commercial List]), at para. 209. He ordered, at para. 258, that the funds be allocated

among the debtor estates in accordance with a number of principles, including the principle that each debtor estate "is to be allocated that percentage of the [liquidation proceeds] that the total allowed claims against that Estate bear to the total allowed claims against all Debtor Estates." A number of parties have sought leave to appeal that decision.

13 It was on June 24, 2014, while the joint allocation trial was proceeding, that the *CCAA* judge directed that the two issues set out above be decided.

C. Decision Below

14 The *CCAA* judge began his analysis with a review of cases applying the interest stops rule in the bankruptcy and winding-up context. He noted the relationship between the interest stops rule and the *pari passu* principle, which he described as "a fundamental tenet of insolvency law" that requires equal treatment of unsecured creditors. He found there was "no reason to not apply the [common law] interest stops rule to a CCAA proceeding because the CCAA does not expressly provide for its application." The issue was "whether the rule should apply to this CCAA proceeding."

15 He went on to conclude that "[t]here is no controlling authority in Canada in a case such as this in which there is a contested claim being made by bondholders for post-filing interest against an insolvent estate under the CCAA, let alone under a liquidating CCAA process, or in which the other creditors are mainly pensioners with no contractual right to post-filing interest." In reaching this conclusion, he distinguished *Stelco* and *Canada 3000* and found that the application of the interest stops rule was supported by the more recent decisions in *Ted Leroy Trucking Ltd., Re*, 2010 SCC 60, [2010] 3 S.C.R. 379 (S.C.C.) [hereinafter *Century Services*], and *Indalex Ltd., Re*, 2013 SCC 6, [2013] 1 S.C.R. 271 (S.C.C.).

16 The *CCAA* judge thus ordered that "holders of Crossover Bond Claims are not legally entitled to claim or receive any amounts under the relevant indentures above and beyond the outstanding principal debt and pre-petition interest (namely, above and beyond US$4.092 billion)."

D. Issues on Appeal

17 The appellant raises two related issues:

1. Did the *CCAA* judge err in concluding that an interest stops rule applies in *CCAA* proceedings?

2. If the *CCAA* judge did not err in concluding that an interest stops rule applies in *CCAA* proceedings, did he err in holding that holders of Crossover Bonds Claims are not legally entitled to claim or receive any amounts under the relevant indentures above and beyond the outstanding principal debt and pre-petition interest?

E. Analysis

(1) Did the CCAA judge err in concluding that an interest stops rule applies in CCAA proceedings?

18 The appellant, supported by the Bank of New York Mellon and the Law Debenture Trust Company of New York as indenture trustees, submits that the *CCAA* judge erred in concluding that the interest stops rule applies.

19 First, the appellant submits he applied inapplicable case law and misinterpreted case law in concluding that the rule did and should apply. Among other things, the appellant criticizes the *CCAA* judge's application of the Supreme Court of Canada's decisions in *Century Services* and *Indalex*, which deal with the inter-play between the *CCAA* and the *Bankruptcy and Insolvency Act*, R.S.C. 1985, c. B-3 (the "*BIA*").

20 The appellant also submits that the application of the interest stops rule in the *CCAA* context is inconsistent with the *CCAA* and would have negative practical consequences.

21 Finally, the appellant submits that *Canada 3000* and *Stelco* are binding authority that preclude the application of the interest stops rule in the *CCAA* context and that the *CCAA* judge violated the principle of *stare decisis* in refusing to follow them.

22 I will deal with these submissions in turn, beginning with a discussion of the interest stops rule and the related *pari passu* principle.

(a) Should the interest stops rule apply in CCAA proceedings?

(i) Origin and scope of the interest stops rule

23 It is well settled that the *pari passu* principle applies in insolvency proceedings. This principle, to the effect that "the assets of the insolvent debtor are to be distributed amongst classes of creditors rateably and equally, as those assets are found at the date of insolvency" is said to be one of the "governing principles of insolvency law" in Canada: *Canada (Attorney General) v. Confederation Life Insurance Co.*, [2001] O.T.C. 486 (Ont. S.C.J. [Commercial List]), at para. 20, *per* Blair J. [2] In fact, the *pari passu* principle has been said to be the foremost principle in the law of insolvency not just in Canada but around the world: Rizwaan J. Mokal "Priority as Pathology: The *Pari Passu* Myth" (2001) 60:3 Cambridge L.J. 581, at p. 581. According to an article in the Cambridge Law Journal, "[c]ommentators claim to have found [the *pari passu*] principle entrenched in jurisdictions far removed ... in geography and time": Mokal, at pp. 581-582.

24 The *pari passu* principle is rooted in the need to treat all creditors fairly and to ensure an orderly distribution of assets.

25 As explained in *Humber Ironworks & Shipbuilding Co., Re* (1869), 4 Ch. App. 643 (Eng. Ch. Div.), nearly 150 years ago, a necessary corollary of the *pari passu* principle is the interest stops rule. Absent the interest stops rule, the fairness and orderly distribution sought by the *pari passu* principle could not be achieved. Selwyn L.J. explained the rationale for the interest stops rule, at pp. 645-646:

> In the present case we have to consider what are the positions of the creditors of the company, when, as here, there are some creditors who have a right to receive interest, and others having debts not bearing interest.
>
> . . . . .
>
> It is very difficult to conceive a case in which the assets of a company could be ... immediately realized and divided; but suppose they had a simple account at a bank, which could be paid the next day, that would be the course of proceeding. Justice, I think, requires that that course of proceeding should be followed, and that no person should be prejudiced by the accidental delay which, in consequence of the necessary forms and proceedings of the Court, actually takes place in realizing the assets; but that, in the case of an insolvent estate, all the money being realized as speedily as possible, should be applied equally and rateably in payment of the debts as they existed at the date of the winding-up. I, therefore, think that nothing should be allowed for interest after that date.

26 Giffard L.J. similarly stated, at p. 647-648:

> That rule ... works with equality and fairness between the parties; and if we are to consider convenience, it is quite clear that, where an estate is insolvent, convenience is in favour of stopping all the computations at the date of the winding-up.
>
> . . . . .
>
> I may add another reason, that I do not see with what justice interest can be computed in favour of creditors whose debts carry interest, while creditors whose debts do not carry interest are stayed from recovering judgment, and so obtaining a right to interest.

27 Thus, the primary purpose behind the common law interest stops rule is fairness to creditors. Another purpose is to achieve the orderly administration of an insolvent debtor's estate.

28 The common law interest stops rule has been consistently applied in proceedings under bankruptcy and winding-up legislation. In fact, as explained by Blair J. in *Confederation Life Insurance Co.* at paras. 22-23, the rule has been applied even when the legislation might be read to the contrary:

> This common law principle has been applied consistently in Canadian bankruptcy and winding-up proceedings. This is so notwithstanding the language of subsection 71(1) of the *Winding-Up Act* and section 121 of the *BIA*, which might be read to the contrary, in my view.
>
> . . . . .
>
> Yet, the "interest stops" principle has always applied to the payment of post-insolvency interest, and the provisions of subsection 71(1) have never been interpreted to trump the common law insolvency "interest stops rule".

29 I will now turn to the question of whether the interest stops rule should be applied in the *CCAA* context.

(ii) Should the interest stops rule apply in CCAA proceedings?

30 The respondents[3] maintain that one would expect the interest stops rule to apply in *CCAA* proceedings given that *CCAA* proceedings are insolvency proceedings to which the common law *pari passu* principle applies. Consistent with the *pari passu* principle and the related interest stops rule, creditors in *CCAA* proceedings must surely expect to be treated fairly and not see creditors with interest entitlements have their claims grow, post-insolvency, disproportionately to those with no, or lesser, interest entitlements. In the respondents' submission, the same reasoning used by courts to conclude that the interest stops rule applies in winding-up and bankruptcy proceedings leads to the conclusion that the interest stops rule applies in *CCAA* proceedings.

31 The appellant, on the other hand, submits that *CCAA* proceedings are different from other insolvency proceedings in that they do not immediately or permanently alter the rights of creditors. The filing is intended to give the debtor breathing space so that a plan of compromise or arrangement can be negotiated with creditors and the business can continue. The objective of a *CCAA* proceeding is a consensual, statutory compromise in the form of a *CCAA* plan. Such a *CCAA* plan can provide for any kind of distribution, provided it is approved by the requisite majority of creditors and the court.

32 In the appellant's submission, until a plan is negotiated or the proceeding is converted to bankruptcy or winding-up, the rights of creditors are not altered; rather, their rights to execute on them are simply stayed. In the appellant's view, therefore, unless and until this sought-after compromise of rights is negotiated, only the exercise of the rights is stayed. The *CCAA* filing does not affect the right to accrue interest; it only stays the collection of that interest.

33 The appellant further argues that the *CCAA* judge's decision is contrary to the established *CCAA* practice and the reasonable expectations of the parties in this proceeding. In particular, the appellant notes that a *CCAA* plan may, and often does, provide for the recovery of post-filing interest. The appellant also submits that the application of the interest stops rule would allow debtors to obtain a permanent interest holiday simply by filing for *CCAA* protection, even if the filing were later withdrawn, causing a permanent prejudice to the creditors not contemplated by the *CCAA*. And, the appellant submits that an interest stops rule would create a disincentive for creditors to participate in *CCAA* proceedings since they would not be compensated for delays under the *CCAA* even if there were ultimately assets available to do so

34 I do not accept the appellant's submissions on this point. Admittedly, there are differences between the *CCAA* and other insolvency schemes, including that the *CCAA* does not provide for a fixed scheme of distribution. Further, assuming a plan of compromise or arrangement under the *CCAA* is negotiated it may or may not result in a distribution to creditors. Nevertheless, in my view, the same principles that underpin the conclusion that the interest stops rule

is necessary in bankruptcy and winding-up proceedings — namely, the fair treatment of creditors and the orderly administration of an insolvent debtor's estate - apply with equal force to *CCAA* proceedings. I say so for several reasons.

35 First, the *CCAA* is part of an integrated insolvency regime, which also includes the *BIA*. The Supreme Court of Canada in *Century Services* considered the *CCAA* regime and opined, at para. 24, that "[w]ith parallel *CCAA* and *BIA* restructuring schemes now an accepted feature of the insolvency landscape, the contemporary thrust of legislative reform has been towards harmonizing aspects of insolvency law common to the two statutory schemes to the extent possible and encouraging reorganization over liquidation". The court went on to explain, at para. 78, that the *CCAA* and *BIA* are related and "no 'gap' exists between the two statutes which would allow the enforcement of property interests at the conclusion of *CCAA* proceedings that would be lost in bankruptcy".

36 Consistent with the notion of harmonization, because the common law interest stops rule applies upon bankruptcy under the *BIA*, it should follow that the common law rule also applies in a *CCAA* proceeding unless, of course, the rule is ousted by the *CCAA*. The *CCAA* does not address entitlement to claim post-filing interest let alone oust the common law rule with clear wording.

37 Second, if the interest stops rule were not to apply in *CCAA* proceedings, the creditors who do not have a contractual right to post-filing interest would, as the Supreme Court explained in *Century Services* at para. 47, have "skewed incentives against reorganizing under the *CCAA*" and this would "only undermine that statute's remedial objectives and risk inviting the very social ills that it was enacted to avert." This concern over skewed incentives was confirmed in *Indalex* where the Supreme Court held, at para. 51, that "[i]n order to avoid a race to liquidation under the *BIA*, courts will favour an interpretation of the *CCAA* that affords creditors analogous entitlements" to those they would receive under the *BIA*.

38 Without an interest stops rule under the *CCAA*, the creditors with no claim to post-filing interest would have an incentive to proceed under the *BIA* or the *Winding-up and Restructuring Act*, R.S.C. 1985, c. W-11, where the interest stops rule operates to prevent creditors, such as the appellant, who have a contractual right to interest from improving their proportionate claim against the debtor at the expense of other creditors.

39 Third, as recognized by the Supreme Court in *Century Services* at para. 77, the "*CCAA* creates conditions for preserving the *status quo* while attempts are made to find common ground amongst stakeholders for a reorganization that is fair to all". This is achieved through grouping all claims within a single proceeding and staying all actions against the debtor, thus putting creditors on an equal footing: *Century Services*, para. 22.

40 As submitted by the Canadian Creditors' Committee, if post-filing interest is available to one set of creditors while the other creditors are prevented from asserting their rights to sue the debtor and obtaining a judgment that bears interest, the *status quo* has not been preserved.

41 Fourth, if the interest stops rule were not to apply in *CCAA* proceedings, the key objective of that statute — to facilitate the restructuring of corporations through flexibility and creativity — may be undermined. This is because of the asymmetrical entitlement to interest that would be created. Creditors with an entitlement to post-filing interest may be less motivated to compromise than those creditors without such an entitlement. Using the case under appeal as an example, if post-filing interest is allowed to accrue, the delay and failure to reach a compromise will see the appellant's proportionate claim against the assets of the debtors rise very significantly at the expense of other creditors. One could well understand that if the urgency for reaching a compromise and the incentive to compromise are significantly lower for one group of unsecured creditors than for the balance of the unsecured creditors, restructuring will be more difficult to achieve and the ability to reach creative solutions will be lessened.

42 Furthermore, if the amount of an unsecured creditor's legal entitlement is constantly shifting as post-filing interest accrues, the ability to find a compromise that is acceptable to all creditors at any one point in time will pose a greater challenge than if the entitlements are fixed as of the date of filing.

43 Fifth, the principle of fairness supports the application of the interest stops rule. Insolvency proceedings are intended to be fair processes for liquidating or restructuring insolvent corporations. How, one may ask, is it fair if the appellant, an unsecured creditor, sees its claim against the assets of the debtor balloon from $4.092 billion to $5.692 billion (as of December 31, 2013) because of contractual provisions when the claims of unsecured creditors, who have no such contractual provisions and who have been prevented for almost seven years by the *CCAA* stay from converting their claims into court judgments that would bear interest, have seen no increase at all? Delays in liquidating the Nortel assets have helped the Monitor achieve the very significant recoveries made ($7.3 billion) and, in fairness, this achievement should be for the benefit of all creditors.

44 Finally, I wish to respond to the appellant's concerns.

45 As to past practice and the reasonable expectations of the parties, I do not view the existence of an interest stops rule as being contrary to established *CCAA* practice or as preventing a *CCAA* plan from providing for post-filing interest. Parties may negotiate for a plan that provides for payments of more or less than a creditor's legal entitlement in lieu of the foregone interest. Thus, I do not accept the appellant's submission that there would be a disincentive to participate in *CCAA* proceedings, which is based on the premise that post-filing interest may not be recovered under a *CCAA* plan.

46 The appellant also raised the concern that a debtor company could obtain a permanent interest holiday, resulting in unfairness. The appellant says that if there are proceeds over and above the amounts needed to satisfy the pre-filing claims of creditors, those proceeds would be for the benefit of the shareholders of the debtor. This follows from the fact that the *CCAA* contains no provision for the payment of a "surplus" to creditors and the interest stops rule would prevent the unsecured creditors from recovering any post-filing interest. The debtor could therefore resort to the *CCAA* to stop interest from accruing and operate his business interest free.

47 This hypothetical raises the same concern about the loss of post-filing interest but in a somewhat different way. The concern is that a debtor may seek *CCAA* protection to avoid the obligation to pay interest.

48 There may well be exceptional situations where, at some point in a *CCAA* proceeding, the common law interest stops rule risks working an unfairness of some sort. I leave for another day what orders, if any, might be made by a *CCAA* judge in cases such as the hypothetical presented by the appellant where a debtor might be considered to benefit unfairly as a result of the common law interest stops rule. I note, however, that in order to achieve the remedial purpose of the *CCAA*, *CCAA* courts have been innovative in their interpretation of their stay power and in the exercise of their authority in the administration of *CCAA* proceedings. This approach has been specifically endorsed by the Supreme Court of Canada in *Century Services* and would no doubt guide the court should the need arise: see, for example, paras. 61 and 70.

49 In conclusion, there are sound reasons for adopting an interest stops rule in the *CCAA* context. I now turn to the argument that *Canada 3000* and *Stelco* preclude the application of the rule.

(b) Are Canada 3000 and Stelco binding authorities to the effect that the interest stops rule does not apply in CCAA proceedings?

50 The appellant vigorously maintains that the *CCAA* judge was bound by *Canada 3000* and *Stelco*, which both confirm that the interest stops rule does not apply in *CCAA* proceedings.

51 I would not give effect to this submission. As I will explain, both of these decisions should be read narrowly and do not constitute a precedent with respect to the issue raised in this appeal — whether the common law interest stops rule applies in *CCAA* proceedings.

(i) Canada 3000

Background and lower court decisions

52 The decision in *Canada 3000* arose out of the collapse of three airlines — Canada 3000 Airlines Ltd. and Royal Aviation Inc. (collectively "Canada 3000"), and Inter-Canadian (1991) Inc. ("Inter-Canadian"). Canada 3000 filed for protection under the *CCAA* and, three days later, filed for bankruptcy. Inter- Canadian filed a *BIA* proposal but the proposal ultimately failed and so it too was placed into bankruptcy effective as of the date it filed its notice of intention to make a proposal.

53 At the time the airlines collapsed, they owed significant amounts in unpaid airport and navigation charges. As a result, various airport authorities and NAV Canada sought remedies under the *Airport Transfer (Miscellaneous Matters) Act*, S.C. 1992, c. 5 ("*Airports Act*") and the *Civil Air Navigation Services Commercialization Act*, S.C. 1996, c. 20 ("*CANSCA*"). In particular, they sought orders seizing and detaining aircraft leased by the bankrupt airlines. While the lessors of the planes retained legal title to the aircraft, the bankrupt airlines were the registered owner for the purposes of the *Aeronautics Act*, R.S.C. 1985, c. A- 2.

54 The airport authorities and NAV Canada brought proceedings in Ontario and Quebec.

55 In Ontario, Ground J. dismissed motions for orders permitting the airport authorities and NAV Canada to seize and detain the aircraft leased by Canada 3000: *Canada 3000 Inc., Re* (2002), 33 C.B.R. (4th) 184 (Ont. S.C.J.). On the question of interest, he concluded, at para. 73, that the airport authorities and NAV Canada were entitled to charge interest on the unpaid charges up to the date of payment or the posting of security for payment.

56 On appeal from Ground J.'s decision, this court held that the interest question need not be determined since the airport authorities and NAV Canada did not have the right to detain the aircraft: *Canada 3000 Inc., Re* (2004), 69 O.R. (3d) 1 (Ont. C.A.), at para. 197.

Supreme Court's decision

57 On appeal to the Supreme Court of Canada, the court determined that the airport authorities and NAV Canada had the right to detain the aircraft leased and operated by the bankrupt airlines. The issue of post-filing interest was, therefore, an issue the court had to decide.

58 In deciding that issue, Binnie J. made the following comment at para. 96:

> While a CCAA filing does not stop the accrual of interest, the unpaid charges remain an unsecured claim provable against the bankrupt airline. The claim does not accrue interest after the bankruptcy: ss. 121 and 122 of the [*BIA*].
>
> [Emphasis added.]

59 The appellant submits that the underlined words are binding *ratio* and must be followed in this case.

60 While I agree that Binnie J.'s comment about the *CCAA* is not *obiter*, I am not convinced that it should be read as broadly as the appellant contends. In *R. v. Henry*, 2005 SCC 76, [2005] 3 S.C.R. 609 (S.C.C.), Binnie J. warned, at para. 57, against reading "each phrase in a judgment ... as if enacted in a statute". Rather, the question to be asked is "what did the case decide?".

61 To answer what *Canada 3000* decided about post-filing interest under the *CCAA*, it is important to consider the context in which Binnie J. made his comment, including the facts of the case, the issues before the court, the structure of his reasons, the wording he used, and what he said as well as what he did not say.

62 At para. 40., Binnie J. defined the "two major questions raised by the appeals" as follows: (1) "are the *legal titleholders* liable for the debt incurred by the registered owners and operators of the failed airlines to the service providers?" and (2) "even if they are not so liable, are *the aircraft* to which they hold title subject on the facts of this case to judicially issued seizure and detention orders to answer for the unpaid user charges incurred by Canada 3000 and

Inter-Canadian?" (emphasis in original). The answer to those two questions turned on the interpretation of the *Airports Act* and *CANSCA*. As Binnie J. noted at para. 36, the case was "from first to last an exercise in statutory interpretation".

63 After engaging in a lengthy exercise of statutory interpretation, he concluded that: (1) under s. 55 of *CANSCA*, the legal titleholders were not jointly and severally liable for the charges due to NAV Canada; and (2) under s. 56 of *CANSCA* and s. 9 of the *Airports Act*, the airport authorities and NAV Canada were entitled to apply for an order detaining the aircraft operated by the failed airlines.

64 Binnie J. then addressed eight additional arguments made by the parties and just before his last paragraph on disposition, he included a section simply entitled "Interest", starting at para. 93.

65 He began his analysis of the interest issue by outlining the statutory authority for charging interest: s. 9(1) of the *Airports Act* expressly provided for the payment of interest, and while *CANSCA* did not explicitly provide for interest, a regulation under *CANSCA* imposed interest: para. 93.

66 "The question then", said Binnie J. at para. 95, was "how long the interest can run". He addressed that question as follows, at paras. 95-96:

> The airport authorities and NAV Canada have possession of the aircraft until the charge or amount in respect of which the seizure was made is paid. It seems to me that this debt must be understood in real terms and must include the time value of money.
>
> Given the authority to charge interest, my view is that interest continues to run to the first of the date of payment, the posting of security or bankruptcy. If interest were to stop accruing before payment has been made, then the airport authorities and NAV Canada would not recover the full amount owed to them in real terms. Once the owner, operator or titleholder has provided security, the interest stops accruing. The legal titleholder is then incurring the cost of the security and losing the time value of money. It should not have to pay twice. While a CCAA filing does not stop the accrual of interest, the unpaid charges remain an unsecured claim provable against the bankrupt airline. The claim does not accrue interest after the bankruptcy: ss. 121 and 122 of the [*BIA*].
>
> [Emphasis added.]

67 Significantly, Binnie J. made no mention in his reasons of the common law interest stops rule or the related *pari passu* principle. Nor did he cite any case law dealing with those issues. In fact, even though it is well established that the interest stops rules applies under the *BIA*, he did not rely on the common law rule in support of his finding that interest stopped on bankruptcy. Instead, he relied on ss. 121 and 122 of the *BIA* in concluding that the interest payable under the *Airports Act* and the regulation under *CANSCA* did not accrue post-bankruptcy.

68 Binnie J.'s analysis of the issue is rooted in the factual and statutory context of the case. In discussing the accrual of interest under the *CCAA*, he specified that the interest was on "unpaid charges", namely charges under *CANSCA* and the *Airports Act*. Binnie J. was not answering an abstract legal question but rather deciding how long interest ran in the particular factual and statutory context.

69 In effect, I read Binnie J. as saying that a *CCAA* filing does not stop the accrual of interest under *CANSCA* or the *Airports Act* but the statutory provisions of the *BIA* ss. 121 and 122 do. He was not deciding whether, in the absence of the right to interest under *CANSCA* and the *Airports Act*, interest would have accrued or been stopped by the common law interest stops rule.

70 Let me add that I agree with the *CCAA* judge's comment that Binnie J.'s statement in *Canada 3000* should "now be construed in light of *Century Services* and *Indalex*". In fact, one can well imagine that the court's interpretation of *CANSCA* and the *Airports Act* as allowing the accrual of interest in a *CCAA* proceeding but not in a *BIA* proceeding

might have been different had it reached the Supreme Court after these two more recent cases. That question, however, is for another day. For now, I turn to this court's decision in *Stelco*.

(ii) Stelco

Background and motion judge's decision

71 The post-filing interest issue in *Stelco* arose in "the final chapter of the financial restructuring of Stelco" under the *CCAA*: *Stelco Inc., Re* (2006), 24 C.B.R. (5th) 59 (Ont. S.C.J. [Commercial List]), at para. 1. The final chapter involved competing claims to a portion of the amount payable to the holders of subordinated notes (the "Junior Noteholders") pursuant to Stelco's plan of arrangement (the "Plan"). The claim to these funds ("Turnover Proceeds") was made by the "Senior Debentureholders".

72 The dispute over the Turnover Proceeds arose after Stelco's Plan had been sanctioned and Stelco had emerged from restructuring with its debt reorganized. The Senior Debentureholders claimed the Turnover Proceeds on the basis of subordination provisions contained in the Note Indenture under which Stelco had issued convertible unsecured subordinated debentures to the Junior Noteholders.

73 Under the terms of the Note Indenture, the Junior Noteholders expressly agreed that, in the event that the debtor became insolvent, they would subordinate their right of repayment until after repayment in full of "Senior Debt".

[74] The plan of arrangement that had been approved was a "no interest" plan, meaning that distribution from Stelco to the creditors did not include or account for post-filing interest. The Plan, however, provided that the rights as between the Senior Debentureholders and the Junior Noteholders were preserved. The Senior Debentureholders, who had not received payment of post-filing interest from Stelco under the Plan, demanded payment of it from the Junior Noteholders pursuant to the terms of the Note Indenture. The Junior Noteholders argued, among other things, that the subordination provisions did not survive the Plan's implementation and that the Senior Debentureholders were not entitled to claim post-filing interest from them.

75 The motion judge, and on appeal, this court ruled in favour of the Senior Debentureholders. The courts found that the Plan was expressly drafted to preserve the subordination provisions and that the *CCAA* does not purport to affect rights as between creditors to the extent that they do not directly involve the debtor.

How to read Stelco?

76 The appellant and the respondents offer different readings of *Stelco*.

77 The appellant argues that this court's decision is binding authority for the proposition that the interest stops rule does not apply in the *CCAA* context. The passages relied on by the appellant include para. 67:

> [T]here is no persuasive authority that supports an Interest Stops Rule in a *CCAA* proceeding. Indeed, the suggested rule is inconsistent with the comment of Justice Binnie in [*Canada 3000*] at para. 96, where he said:
>
> > While a *CCAA* filing does not stop the accrual of interest, the unpaid charges remain an unsecured claim provable against the bankrupt airline. The claim does not accrue interest after the bankruptcy: ss. 121 and 122 of the [*BIA*].

78 The respondents, for their part, read the case more narrowly as a resolution of an inter-creditor dispute. They submit that the *ratio* of the case is that there was no rule that prohibited giving effect to the agreed upon inter- creditor postponement. To the extent that this court discussed the interest stops rule in the abstract, its comments are *obiter*.

79 I agree with the respondents. In my view, the court in *Stelco* did not need to decide whether the interest stops rule applies in *CCAA* proceedings for it to decide the inter-creditor dispute before the court and so its statements about the rule's application are not binding.

80 This court expressly noted, at para. 44, that it was dealing with an inter-creditor dispute. The Junior Noteholders had accepted the subordination terms in the Note Indenture. They had agreed not to be paid anything, in the event of insolvency, until those who held Senior Debt were paid principal and interest in full. The court affirmed, at para. 44, that the *CCAA* does not change the relationship among creditors where it does not directly involve the debtor.

81 As noted, this was a "no interest" plan, meaning that the Senior Debentureholders received no post-filing interest from Stelco. Rather, they sought and eventually received payment of post-filing interest from the Junior Noteholders' share of the proceeds. The court found that the Stelco Plan contemplated the continued accrual of interest to Senior Debentureholders for the purpose of their rights as against the Junior Noteholders after the *CCAA* filing date: paras. 59 and 70. It noted that *CCAA* plans can and sometimes do provide for payments in excess of claims filed in *CCAA* proceedings. There was no rule precluding the payment of post-filing interest to the Senior Debentureholders in accordance with the Stelco Plan: para. 70.

82 The court's conclusion that the Junior Noteholders could not rely on the interest stops rule is consistent with the traditional interest stops rule. The interest stops rule relates to claims by creditors against the debtor. It does not deal with arrangements as between creditors. In other words, whether or not the interest stops rule applies in *CCAA* proceedings did not need to be decided because the agreement between creditors fell outside the scope of that rule.

83 The appellant makes two further submissions based on its interpretation of s. 6.2(1) of the Note Indenture. That paragraph reads as follows:

> 6.2 Distribution on Insolvency or Winding-up.
>
> . . . . .
>
> (1) the holders of all Senior Debt will first be entitled to receive payment in full of the principal thereof, premium (or any other amount payable under such Senior Debt), if any, and interest due thereon, before the Debentureholders will be entitled to receive any payment or distribution of any kind or character, whether in cash, property or securities, which may be payable or deliverable in any such event in respect of any of the Debentures;
>
> [Emphasis added.]

84 The first argument is that the Senior Debentureholders were only entitled to receive principal, premium and interest "which may be payable or deliverable in any such event", the event being insolvency or bankruptcy proceedings. Therefore, the court must have concluded, at least implicitly, that the Senior Debentureholders would have been entitled to maintain their claim for post-filing interest against Stelco.

85 The second argument is that, by the terms of s. 6.2(1), the Senior Debentureholders were only entitled to interest "due thereon" and so they could not claim post-filing interest from the Junior Noteholders unless they could claim post-filing interest from Stelco.

86 I would not give effect to either submission.

87 In *Stelco*, the court did not address either argument and we do not have a copy of the entire agreement nor do we have the other agreements that form part of the factual matrix. Without that context, this court is not in the position to interpret s. 6.2(1).

88 In my view, the key question for this court is not how to properly interpret s. 6.2(1) but, rather, how we should read the reasons in *Stelco*. What did the *Stelco* court decide, and specifically, should we read the panel as implicitly deciding that the Senior Debentureholders could not recover post-filing interest from the Junior Noteholders unless they could claim post-filing interest against Stelco?

89 In discussing post-filing interest, the court's only mention of the Senior Debentureholders' claim as against Stelco is found at paras. 57-59, where the panel expressly rejected the argument that "any claim the Senior [Debentureholders] have for interest must be based on a "claim" [as defined in the Plan] they have against Stelco for such interest" and that "[i]f the Senior Debt does not include post-filing interest, there can be no claim against the [Junior] Noteholders for such amounts": see paras. 58-59.

90 Admittedly, the panel made this comment in discussing the effect of the Stelco Plan as opposed to the effect of the interest stops rule. However, as I read the section on post-filing interest as a whole, the court is saying that the Junior Noteholders agreed to be bound by the deal they made. They had agreed to the subordination provisions that guaranteed full payment to the Senior Debentureholders in the event of insolvency, and the Plan affirmed that the Senior Noteholders could claim the full amount that would have been owing had there been no *CCAA* filing. In this court's words at para. 70, there is no interest stops rule "that precludes such a result." In my view, therefore, this court did not make an implicit finding that the Senior Debentureholders had to be able to claim post-filing interest from Stelco in order to claim post-filing interest from the Junior Noteholders.

91 In conclusion, I consider the comment that there is no persuasive authority that supports an interest stops rule in *CCAA* proceedings to be *obiter*. *Stelco* dealt with the effect of an agreement as between creditors as to how, between them, they would share distributions. Whether or not interest stops upon a *CCAA* filing was of no import in answering that question.

(2) If the CCAA judge did not err in concluding that an interest stops rule applies in CCAA proceedings, did he err in holding that holders of Crossover Bonds Claims are not legally entitled to claim or receive any amounts under the relevant indentures above and beyond the outstanding principal debt and pre-petition interest?

92 The appellant objects to the wording of the *CCAA* judge's order. It provides that "holders of Crossover Bond Claims are not legally entitled to claim *or receive* any amounts under the relevant indentures above and beyond the outstanding principal debt and pre-petition interest" (emphasis added). While the appellant asked the *CCAA* judge to amend his order to delete "or receive", he refused. The appellant submits that, to the extent this precludes the bondholders from receiving post-filing interest under a *CCAA* plan, the *CCAA* judge erred. The appellant notes that all the parties in this proceeding agree that a *CCAA* plan may provide for post-filing interest.

93 As I explained above, the interest stops rule does not preclude the payment of post-filing interest under a plan of compromise or arrangement.

94 As I read the *CCAA* judge's reasons and order, he did not decide otherwise. His decision confirms that the common law interest stops rule applies in *CCAA* proceedings. If a plan of compromise or arrangement is concluded, it should not, for example, be read as limiting any right to recover post-filing interest creditors may have as amongst themselves, as existed in *Stelco*, or from non-parties. Nor does it dictate what any creditor may seek in bargaining for a fair plan of compromise or arrangement. In that regard, I do not interpret the *CCAA* judge's use of the words "or receive" as preventing the appellant from seeking and obtaining such a result in a negotiated plan. In particular, I note the *CCAA* judge's comment at para. 35 of his reasons that "the parties would of course be free to include post-filing interest payments in a plan of arrangement, as is sometimes done."

95 The appellant also seeks clarification as to the effect of the words "*any amounts* under the relevant indentures above and beyond the outstanding principal debt and pre-petition interest" (emphasis added). The appellant notes that, without clarification, the wording of the order could potentially preclude the recovery of other contractual entitlements under

the relevant indentures, such as costs and make-whole provisions, even though no arguments were advanced before the *CCAA* judge with respect to any amounts other than post-filing interest.

96 The issue the *CCAA* judge was directed to answer was "whether the holders of the crossover bond claims ... [were] legally entitled ... to claim or receive any amounts under the relevant indentures above and beyond the outstanding principal debt and pre-petition interest". As indicated in the appellant's factum, the only arguments advanced before the *CCAA* judge related to post-filing interest and not any other amounts under the indentures. The appellant does not appear to have made submissions to the *CCAA* judge with respect to the costs and make-whole fees it now raises in its factum. This court is in no position to deal with the new argument raised by the appellant. Further, beyond making the broad submission noted above, the appellant did not expand on that submission and direct the court to the specific claims or indenture provisions it relies on in support of its argument or explain why the claims should not be caught by the order.

97 As I have already indicated, the *CCAA* judge's order confirms that the interest stops rule, and the limits imposed by the rule, apply in *CCAA* proceedings. To the extent that the appellant maintains that there are other contractual entitlements under the relevant indentures not covered by the interest stops rule, it is up to the *CCAA* court to decide if those can now be raised and ruled upon.

F. Final Comments

98 I acknowledge that the Nortel *CCAA* proceedings are exceptional, particularly with respect to the length of the delay. The amount the appellant claims for post-filing interest and related claims under the indentures, and the resulting impact on other unsecured creditors is so great because of the length of that process. The principle, however, is the same whether the *CCAA* process is short or long. After the imposition of a stay in *CCAA* proceedings, allowing one group of unsecured creditors to accumulate post-filing interest, even for a relatively short period of time, would constitute unfair treatment vis-à-vis other unsecured creditors whose right to convert their claim into an interest-bearing judgment is stayed.

99 This decision does not purport to change or limit the powers of *CCAA* judges. Although the decision clearly settles at the outset of a *CCAA* proceeding whether there is a legal entitlement to post-filing interest, it does not dictate how the proceeding will progress thereafter until a plan of compromise or arrangement is approved, or the *CCAA* proceeding is otherwise brought to an end.

100 The determination of legal entitlement is important as it clearly establishes the starting point in a *CCAA* proceeding. It tells creditors, debtors and the court what legal claim a particular creditor has. Its significance is not only for purposes of setting the voting rights of creditors on any proposed plan of compromise or arrangement, it also ensures that, in assessing any such proposed plan, the parties will know what they are or are not compromising and the court will be equipped to consider the fairness of such a plan.

G. Disposition

101 For these reasons, I would dismiss the appeal. Pursuant to the agreement of the parties, I would award the respondent Monitor, as successful party, costs as against the appellant fixed in the amount of $40,000, inclusive of disbursements and applicable taxes. I would make no other order as to costs.

Janet Simmons J.A.:

I agree

E.E. Gillese J.A.:

I agree

Appeal dismissed.

Footnotes

1 There are five Canadian Debtors: Nortel Networks Corporation, Nortel Networks Limited, Nortel Networks Technology Corporation, Nortel Networks International Corporation and Nortel Networks Global Corporation.

2 As explained in Roderick J. Wood's text on bankruptcy and insolvency law, "insolvency law is the wider concept, encompassing bankruptcy law but also including non-bankruptcy insolvency systems.": Roderick J. Wood, *Bankruptcy & Insolvency Law* (Toronto: Irwin Law Inc., 2009), at p. 1.

3 The respondents are the Monitor, the Canadian Debtors, the Canadian Creditors' Committee and the Wilmington Trust, National Association. While technically The Bank of New York Mellon and the Law Debenture Trust Company of New York are also respondents, they support the appellant's position and so my use of the term "respondents" excludes them.

End of Document

TAB 19

1956 CarswellNat 247
Supreme Court of Canada

Goodyear Tire & Rubber Co. of Canada Ltd. v. T. Eaton Co.

1956 CarswellNat 247, [1956] S.C.R. 610, [1956] S.C.J. No. 37,
16 Fox Pat. C. 91, 28 C.P.R. 25, 4 D.L.R. (2d) 1, 56 D.T.C. 1060

The Goodyear Tire and Rubber Company of Canada Limited, Firestone Tire and Rubber Company of Canada Limited, B.F. Goodrich Company of Canada Limited, Appellants and The T. Eaton Company Limited and Others, Respondents

Kerwin C.J., Rand, Fauteux, Abbott and Nolan JJ.

Judgment: May 3, 1956
Judgment: May 4, 1956
Judgment: June 11, 1956

Proceedings: reversed *Goodyear Tire & Rubber Co. of Canada Ltd. v. T. Eaton Co.*, 1955 CarswellNat 7, [1955] Ex. C.R. 229, 55 D.T.C. 1103, 23 C.P.R. 75, 16 Fox Pat. C. 28 ((Can. Ex. Ct.))

Counsel: *J.J. Robinette, Q.C.* and *J.B. Lawson* for the appellants.
J.D. Arnup, Q.C. and *G.F. Henderson, Q.C.* for T. Eaton Co.
Stuart Thom, Q.C. for General Tire & Rubber Co.
R.M. Sedgewick and *C.W. Lewis* for Simpsons-Sears Ltd.
K.E. Eaton for Minister of National Revenue.

Subject: Intellectual Property; Property; Tax — Miscellaneous

Headnote

Taxation --- Federal taxation — Federal sales tax — Interpretation — Manufacturer or producer

Who is — "Special brand" automobile tires made by manufacturer for sale to certain retailer — Tires bearing name of retailer — Retailer not to be treated as manufacturer or producer of tires — Excise Tax Act, R.S.C. 1952, c. 100, s. 57, 57(1)(2).

Whether a particular person is a person upon whom a tax is imposed in respect of an article or whether a particular article is one in respect of which a tax is imposed upon a person are two separate questions. While those two questions are proper ones in an action for the recovery of taxes, it does not follow that they are all equally so in a reference to the Tariff Board under s. 57 of the Act if, on a proper construction of the whole section, the question as worded in subsection (1) "whether any or what rate of tax is payable on any article" means only whether any article is one in respect of which any and, if so, what rate of tax is imposed. S. 57(1) contemplates that the question to be propounded to the Board is, of its nature, susceptible to be one upon which a previous decision binding throughout Canada might have been rendered. Under s. 57(2), the Board is precluded from deciding the question, which under s. 57(1) is within its jurisdiction to entertain, unless a hearing be provided for and notice thereof published in the Canada Gazette, so that anyone -- other than the person who applies for the declaration, the Deputy-Minister of National Revenue for Customs or Excise -- may be given an opportunity to enter an appearance and be heard in the matter. Whether or not a particular article is one in respect of which a tax is imposed raises a question of general concern throughout Canada and is a matter justifying notice being given to third parties so that they may be heard

if they so elect. But whether a particular person is the person liable for the payment of a tax imposed in respect of an article is an issue between that person and the Crown. To permit third parties to intervene in such an issue would be a departure from the general system of the law. Held, the Tariff Board had no jurisdiction to decide whether a particular person was the manufacturer or producer of tires.

Appeal from the judgment of the Exchequer Court of Canada, reported *ante* at p. 28 allowed.

Held, that the Tariff Board had no jurisdiction to deal with the matter.

Whether or not a particular article is one in respect of which a tax is imposed raises a question of general concern thro ughout Canada and is a matter justifying notice being given to third parties so that they may be heard if they so elect. But whether a particular person is the person liable for the payment of a tax imposed in respect of an article is an issue betw een that person and the Crown. To permit third parties to intervene in such an issue would be a departure from the general s ystem of the law.

In interpreting the words of a statute it is proper to refer to the French version.

Table of Authorities

Cases considered by *Fauteaux, J.*:

C.A.P.A.C. v. Western Fair Assn. (1951), (sub nom. *Composers, Authors & Publishers Assn. (Canada) v. Western Fair Assn.)* 12 Fox Pat. C. 1, [1951] S.C.R. 596, 15 C.P.R. 45, [1952] 2 D.L.R. 229, 1951 CarswellOnt 98 (S.C.C.) — followed

Goodyear Tire & Rubber Co. of Canada Ltd. v. T. Eaton Co. (1955), [1955] Ex. C.R. 229, 55 D.T.C. 1103, 23 C.P.R. 75, 1955 CarswellNat 266 (Can. Ex. Ct.) — referred to

Okalta Oils Ltd. v. Minister of National Revenue (1955), [1955] S.C.R. 824, [1955] C.T.C. 271, 55 D.T.C. 1176, [1955] D.L.R. 614, 1955 CarswellNat 248 (S.C.C.) — considered

Statutes considered:

Excise Tax Act, R.S.C. 1952, c. 100
Generally — referred to

s. 2(a) "manufacturer or producer" (ii) — considered

s. 23(2) — considered

s. 30(1)(a)(i) — considered

s. 57 — considered

s. 57(1) — considered

s. 57(2) — considered

s. 57(3) — considered

Special War Revenue Act, R.S.C. 1927, c. 179
s. 115 — referred to

The judgment of Kerwin C.J., Fauteux, Abbott and Nolan JJ. was delivered by *Fauteux J.*:

1 For some years, certain Canadian rubber companies have been manufacturing "special brand" automobile tires for sale to various retail corporations as well as to other rubber companies. These tires bear the names of the purchasers and the treads are molded with special markings which are not sold to others. The first mentioned companies have been regarded by the Department as the manufacturers or producers of the tires for the purposes of the *Excise Tax Act* (R.S.C. 1952, c. 100). The appellants, competing manufacturers of automobile tires, objected to this ruling and contended that the "special brand" customers should be treated as the manufacturers or producers of the tires within the meaning of section 2(*a*)(ii) of the *Excise Tax Act* and subjected to sales and excise taxes on their sales. In a letter dated August 19, 1954, wherein these facts are recited, the Deputy Minister of National Revenue referred the matter to the Tariff Board for a declaration as to the correctness or otherwise of the Department's ruling; this reference purports to be made in accordance with section 57 of the Act, the relevant subsections of which provide that: —

> (1) Where any difference arises or where any doubt exists as to whether any or what rate of tax is payable on any article under this Act and there is no previous decision upon the question by any competent tribunal binding throughout Canada, the Tariff Board constituted by the *Tariff Board Act* may declare what amount of tax is payable thereon or that the article is exempt from tax under this Act.
>
> (2) Before making a declaration under subsection (1) the Tariff Board shall provide for a hearing and shall publish a notice thereof in the *Canada Gazette* at least twenty-one days prior to the day of the hearing; and any person who, on or before that day, enters an appearance with the Secretary of the Tariff Board may be heard at the hearing.
>
> (3) A declaration by the Tariff Board under this section is final and conclusive, subject to appeal as provided in section 58.
>
> (4) ...
>
> (5) ...

2 During the hearing of this reference, members of the Board raised the question of jurisdiction. In the views they then expressed, the difference arising in the matter is not, as contemplated in subsection (1) of the section 57 "whether any or what rate of tax is payable" on these articles, under the Act — a question as to which, admittedly, no difference or doubt existed in the premises — , but whether the Canadian rubber companies manufacturing "special brand" automobile tires for sale to various retail corporations or the retail corporations, should be regarded by the Department as the manufacturers or producers, within the meaning of the section 2(*a*)(ii) and should therefore pay the tax — a question scarcely within the terms of a reference authorized under section 57. The point was argued but not determined. The Board, acting upon the suggestion of counsel of the Minister, continued the hearing, "leaving the question of jurisdiction open to be settled elsewhere" and, on the merits of the question referred to, approved the ruling of the Department. This decision as well as the authority of the Board to entertain the reference, were subsequently affirmed by the Exchequer Court on an appeal by the present appellants who, continuing to assert the jurisdiction of the Board, now attack the judgment rendered on the merits of the question.

3 The jurisdiction of the Board in the matter must first be ascertained for, if there is no such jurisdiction, this Court, as well as the Board and the Exchequer Court, is precluded from entering upon a consideration of the merits of the issue. *Okalta Oils Limited v. Minister of National Revenue* [1].

4 The contention that the question propounded to the Board in the present case is one contemplated by the terms of section 57, is predicated on the argument of counsel for the Minister that the words "by any persons" must be understood

to follow the word "payable" twice appearing in the first paragraph of the section; and the reasons upon which rests the decision of the Court below are expressed as follows: —

> That the tax is imposed on a person in respect of an article and not on the article itself, notwithstanding the wording of section 57, seems clear: *vide* such cases as *Provincial Treasurer of Alberta v. Kerr* (1933) A.C. 710; *Kerr v. Superintendent of Income Tax and Attorney-General for Alberta* (1942) S.C.R. 435; *Smith v. Vermillion Hills Rural Council* (1916) 2 A.C. 569. The articles that were the subject of the reference were "special brand" automobile tires. As the hearing developed the specific articles before the Board were the special brand "Bulldog" and "Trojan" tires sold by Eaton's. Since there was difference or doubt whether Eaton's was the manufacturer or producer of the tires there was difference or doubt whether tax was payable on them on their sale by Eaton's. The Board could not determine such difference or doubt and decide whether tax was payable on the tires or whether they were exempt from tax on their sale by Eaton's without deciding whether Eaton's was the manufacturer or producer of them. Failure to recognize this basic fact was the fallacy in the submission of lack of jurisdiction. Since there was difference or doubt whether any tax was payable on the "Bulldog" and "Trojan" tires on their sale by Eaton's the Board had jurisdiction to resolve such doubt or difference. And since the Board could not resolve such doubt or difference without deciding whether Eaton's was the manufacturer or producer of the tires it follows, as a matter of course, that it had jurisdiction to decide that question.

5 With deference, I fail to see how this line of reasoning is of any assistance in determining the specific jurisdiction of the Tariff Board under section 57 of the Act. Whether a *particular person* is a person upon whom a tax is imposed in respect of an article or whether a *particular article* is one in respect of which a tax is imposed upon a person are two separate questions; — indeed the whole argument at the hearing was centered exclusively upon the former, nothing being said as to the latter, as to which there was admittedly no point of difference. While these two questions, as well as a variety of others, are proper ones in an action for the recovery of taxes, it does not follow that they are all equally so in a reference to the Tariff Board under section 57 if, on a proper construction of the whole section, the question as worded in paragraph (1) "whether any or what rate of tax is payable on any article" means only whether any article is one in respect of which any and, if so, what rate of tax is imposed.

6 The declaration of the Board as to the question within its jurisdiction to entertain is, subject to appeal by leave on a question of law only, final and conclusive as against any of the parties to the proceedings, and perhaps as against anyone in Canada who, after publication in the *Canada Gazette* of a notice of a hearing, has failed to avail himself of the right to appear before and to be heard by the Board. In the result, one at least of the many issues, which ordinarily it would be for the Exchequer Court or some other competent tribunal to determine, either in an action for recovery of taxes or penal proceedings, is finally and conclusively decided by the Board. That section 57 thus affords a substantial alteration of the general system of the law and particularly of the provisions of the Act dealing with the recovery of taxes, is manifest. In like circumstances, the construction of this subsequent enactment, section 57, is subject to the rule that a Legislature is not presumed to depart from the general system of the law without expressing its intentions to do so with irresistible clearness, failing which the law remains undisturbed. (Maxwell *On Interpretation of Statutes*, 9th edition, page 84). There being a presumption against the implicit alteration of the law, effect cannot be given to the suggestion of counsel for the Department to read after the word "payable" twice appearing in the first paragraph of the section, the words "by any persons". To do so would not only extend the scope of the question but stretch it to a point creating clear conflict between the English and the French texts of paragraph (1). Indeed if one refers, as one may under the authorities (*Composers, Authors and Publishers Association Limited v. Western Fair Association*[2]), to the French version, the latter makes it abundantly clear that the real question is "whether any particular article is one in respect of which any or what rate of tax is imposed": —

> 57. (1) Lorsqu'il se produit un différend ou qu'un doute existe sur la question de savoir si, aux termes de la présente loi, *un article est assujéti à la taxe ou sur le taux applicable à l'article* et qu'aucun tribunal compétent n'a jusque-là rendu, en l'espèce, une décision visant tout le Canada, la Commission du tarif, instituée par la *Loi sur la Commission*

> *du tarif*, peut déclarer quel montant de taxe est exigible sur l'article ou déclarer que l'article est exempt de la taxe en vertu de la préente loi.

In the context, the word "payable" does not appear; and the context does not either lend itself to the inclusion of the words "payable par quiconque". While, on these views, it must be held that there was no jurisdiction for the Board to entertain the question propounded in the letter of the Deputy Minister, this conclusion, if the examination of the section is pursued, finds, I think, further support.

7 As is manifested by the reasons for the declaration of the Board and for the judgment of the Court below upon the merits of the question referred to the Board, the declaration as well as the judgment rest on findings of facts as to the relationship between the T. Eaton Company Limited and the Dominion Rubber Company Limited.

8 Under paragraph (1) of section 57, a condition precedent to the jurisdiction of the Board to entertain a reference upon the question stated in the section is that there be "no previous decision upon the question by a competent tribunal *binding throughout Canada*". The section, therefore, contemplates that the question to be propounded to the Board is, of its nature, susceptible to be one upon which a previous decision binding throughout Canada might have been rendered. Of its nature, the question here arising can hardly give rise to a decision having such an effect.

9 Under paragraph (2), the Board is precluded from deciding the question, which under paragraph (1) is within its jurisdiction to entertain, unless a hearing be provided for and notice thereof published in the *Canada Gazette*, so that anyone, — other than the person who applies for the declaration, the Deputy-Minister of National Revenue for Customs or Excise, — may be given an opportunity to enter an appearance and be heard in the matter. Whether or not a particular article is one in respect of which a tax is imposed raises a question of general concern throughout Canada and is a matter justifying notice being given to third parties so that they may be heard if they so elect. But whether a particular person is the person liable for the payment of a tax imposed in respect of an article is an issue between that person and the Crown. To permit third parties to intervene in such an issue would be a departure from the general system of the law. The intention of Parliament to do so would have to be indicated in explicit terms, which, in my view, has not been done under the section.

10 Paragraph (3) provides that "a declaration by the Tariff Board under this section is final and conclusive, subject to appeal as provided in section 58". Prior to 15 Geo. VI, c. 28, s. 7, enacted in 1951, what is now paragraph (3) read as follows: —

> A declaration by the Tariff Board, under this section, shall have the same force and effect as if it had been sanctioned by statute.

The question which could then be referred to the Board was exactly the same as it is to-day. If the question contemplated by section 57 is whether a *particular article* is one in respect of which any and what rate of tax is imposed, it is not difficult to understand why Parliament wanted to give to the determination of this question the same force and effect as if it had been sanctioned by statute, but there would appear to be no reason for the attribution of such an effect to the determination of tax liability of a person arising out of the relationship existing between that person and another.

11 Upon the ground that the Tariff Board had no jurisdiction to make its declaration of December 7, 1954, I would allow the appeal and set aside the judgment of the Exchequer Court and the Tariff Board's declaration. There should be no costs in this Court or in the Exchequer Court.

***Rand J.*:**

12 I agree with the conclusion and with the reasons generally of my brother Fauteux, but I desire to state shortly my own view of s. 57 of the *Excise Tax Act*. S-s. (1) declares:

> Where any difference arises or where any doubt exists as to whether any or what rate of tax is payable on any article under this Act and there is no previous decision upon the question by any competent tribunal binding throughout Canada, the Tariff Board constituted by the Tariff Board Act may declare what amount of tax is payable thereon or that the article is exempt from tax under this Act.

The language "whether any or what rate of tax is payable on any article" raises a question that, in effect, asks for a decision in rem, a decision determining the rate as applied to the article regardless of personal liability for the tax. It is only for that reason that a general hearing is required and that the declaration is to be, by s-s. (3), "final and conclusive". That is the only question authorized by the section to be put by the Deputy Minister to the Board.

13 It is argued that the language "may declare what amount of tax is payable thereon" evidences an intention to have such a question as that submitted passed upon. The point is, no doubt, arguable, but what is to be resolved, is a doubt or difference as to the rate; the price is assumed; and once the rate is ascertained the amount of the tax mathematically follows. Even considering s-s. (1) alone, I think the jurisdiction is clearly confined to the question specified in two lines, "any or what rate of tax", and the use of the word "amount" cannot, in the context, affect it. Confirmed, however, as that interpretation is by the subsequent subsections, I entertain no doubt of the limit of jurisdiction.

14 What is sought here is something quite different: it is, who, as the "manufacturer or producer" of the goods, is, as between two parties, liable for the tax? The article and the rate are admitted. S. 23(2) and s. 30(1)(*a*)(i) provide for the payment of the excess and consumption taxes respectively by the "manufacturer or producer". S. 2(1)(*a*)(ii) defines "manufacturer or producer" to include:

> any person, firm or corporation that owns, holds, claims, or uses any patent, proprietary, sales or other right to goods being manufactured, whether by them, in their name, or for or on their behalf by others, whether such person, firm or corporation sells, distributes, consigns, or otherwise disposes of the goods or not,

15 The question is, therefore, one of fact and law whether the respondent retail dealers, by reason of their partial participation in the processes that end in the ultimate product, bring themselves within that description. The interest of a taxpayer in that question is not the general interest in a definitive determination which s. 57, s-s. (1) contemplates. Each instance depends on its own particulars; they may be changed in any case tomorrow by adding, subtracting or combining old or new items; and the declaration would be only upon the particulars then existing of the party immediately concerned. That is here an issue between the retailer and the Crown with which ordinarily other parties have nothing directly to do. They may be interested in the language of the statute and might seek its change; they have an interest in the uniform and proper administration of the Act as of taxing law generally; but as between the taxing authorities and the "manufacturer or producer" that is not the interest for which the section provides a general hearing.

16 I would, therefore, allow the appeal, set aside the judgment below and declare the Tariff Board to have had no jurisdiction to make the declaration. There will be no costs in this Court or in the Exchequer Court.

Rand, J:

17 I agree with the conclusion and with the reasons generally of my brother Fauteux, but I desire to state shortly my own vi ew of s. 57 of the *Excise Tax Act*, R.S.C. 1952, c. 100, S-s. (1) declares:

> Where any differ ence arises or where any doubt exists as to whether any or what rate of tax is payable on any article under this Act and the re is no previous decision upon the question by any competent tribunal binding throughout Canada, the Tariff Board constit uted by the Tariff Board Act may declare what amount of tax is payable thereon or that the article is exempt from tax under this Act.

18 The language "whether any or what rate of tax is payable on any article" raises a question that, in effect, a sks for a decision *in rem*, a decision determining the rate as applied to the article regardless of personal liabili ty for the tax. It is

only for that reason that a general hearing is required and that the declaration is to be, by s-s. (3) , "final and conclusive". That is the only question authorized by the section to be put by the Deputy Minister to the Board.

19 It is argued that the language "may declare what amount of tax is payable thereon" evidences an intention to have such a question as that submitted passed upon. The point is, no doubt, arguable, but what is to be resolved is a doubt or difference as to the rate; the price is assumed; and once the rate is ascertained the amount of the tax mathematically fo llows. Even considering s-s. (1) alone, I think the jurisdiction is clearly confined to the question specified in two lines, "any or what rate of tax", and the use of the word "amount" cannot, in the context, affect it. Conf irmed, however, as that interpretation is by the subsequent subsections, I entertain no doubt of the limit of jurisdiction.

20 What is sought here is something quite different. It is, who, as the "manufacturer or producer" of the goods, is, as between two parties, liable for the tax? The article and the rate are admitted. Section 23(2) and s. 30(1)(*a*)(i) provide for the payment of the excess and consumption taxes respectively by the "manufacturer or producer" . Section 2(1)(*a*)(ii) defines "manufacturer or producer" to include

> any person, firm or corp oration that owns, holds, claims, or uses any patent, proprietary, sales or other right to goods being manufactured, whether by them, in their name, or for or on their behalf by others, whether such person, firm or corporation sells, distributes, c onsigns, or otherwise disposes of the goods or not.

21 The question is, therefore, one of fact and law whether the respondent retail dealers, by reason of their partial partici pation in the processes that end in the ultimate product, bring themselves within that description. The interest of a taxpay er in that question is not the general interest in a definitive determination which s. 57(1) contemplates. Each instance dep ends on its own particulars; they may be changed in any case tomorrow by adding, subtracting or combining old or new items; and the declaration would be only upon the particulars then existing of the party immediately concerned. That is here an iss ue between the retailer and the Crown with which ordinarily other parties have nothing directly to do. They may be intereste d in the language of the statute and might seek its change; they have an interest in the uniform and proper administration o f the Act as of taxing law generally; but as between the taxing authorities and the "manufacturer or producer"th at is not the interest for which the section provides a general hearing.

22 I would, therefore, allow the appeal, set aside the judgment below and declare the Tariff Board to have had no jurisdiction to make the declaration. There will be no costs in this Court or in the Exchequer Court.

Appeal allowed; no costs.

Solicitors of record:
Solicitors for the appellants: *McCarthy & McCarthy.*
Solicitors for T. Eaton Co.: *Gowling, MacTavish, Osborne & Henderson.*
Solicitor for Simpsons-Sears Ltd.: *Tory, Miller, Thomson, Hicks, Arnold & Sedgewick.*
Solicitor for Atlas Supply Co.: *J.F. Barrett.*
Solicitor for General Tire & Rubber Co.: *Osler, Hoskin & Harcourt.*
Solicitor for Minister of National Revenue: *K.E. Eaton.*

Footnotes

1 [1955] S.C.R. 824.

2 [1951] S.C.R. 596.

TAB 20

2010 SCC 60
Supreme Court of Canada

Ted Leroy Trucking [Century Services] Ltd., Re

2010 CarswellBC 3419, 2010 CarswellBC 3420, 2010 SCC 60, [2010] 3 S.C.R. 379, [2010] G.S.T.C. 186, [2011] 2 W.W.R. 383, [2011] B.C.W.L.D. 533, [2011] B.C.W.L.D. 534, 12 B.C.L.R. (5th) 1, 196 A.C.W.S. (3d) 27, 2011 D.T.C. 5006 (Eng.), 2011 G.T.C. 2006 (Eng.), 296 B.C.A.C. 1, 326 D.L.R. (4th) 577, 409 N.R. 201, 503 W.A.C. 1, 72 C.B.R. (5th) 170, J.E. 2011-5

Century Services Inc. (Appellant) and Attorney General of Canada on behalf of Her Majesty The Queen in Right of Canada (Respondent)

Deschamps J., McLachlin C.J.C., Binnie, LeBel, Fish, Abella, Charron, Rothstein, Cromwell JJ.

Heard: May 11, 2010
Judgment: December 16, 2010
Docket: 33239

Proceedings: reversing *Ted Leroy Trucking Ltd., Re* (2009), 2009 CarswellBC 1195, 2009 G.T.C. 2020 (Eng.), 2009 BCCA 205, 270 B.C.A.C. 167, 454 W.A.C. 167, [2009] 12 W.W.R. 684, 98 B.C.L.R. (4th) 242, [2009] G.S.T.C. 79 (B.C. C.A.); reversing *Ted Leroy Trucking Ltd., Re* (2008), 2008 CarswellBC 2895, 2008 BCSC 1805, [2008] G.S.T.C. 221, 2009 G.T.C. 2011 (Eng.) (B.C. S.C. [In Chambers])

Counsel: Mary I.A. Buttery, Owen J. James, Matthew J.G. Curtis for Appellant
Gordon Bourgard, David Jacyk, Michael J. Lema for Respondent

Subject: Estates and Trusts; Goods and Services Tax (GST); Tax — Miscellaneous; Insolvency

Headnote

Tax --- Goods and Services Tax — Collection and remittance — GST held in trust

Debtor owed Crown under Excise Tax Act (ETA) for unremitted GST — Debtor sought relief under Companies' Creditors Arrangement Act (CCAA) — Under order of BC Supreme Court, amount of GST debt was placed in trust account and remaining proceeds of sale of assets paid to major secured creditor — Debtor's application for partial lifting of stay of proceedings to assign itself into bankruptcy was granted, while Crown's application for payment of tax debt was dismissed — Crown's appeal to BC Court of Appeal was allowed — Creditor appealed to Supreme Court of Canada — Appeal allowed — Analysis of ETA and CCAA yielded conclusion that CCAA provides that statutory deemed trusts do not apply, and that Parliament did not intend to restore Crown's deemed trust priority in GST claims under CCAA when it amended ETA in 2000 — Parliament had moved away from asserting priority for Crown claims under both CCAA and Bankruptcy and Insolvency Act (BIA), and neither statute provided for preferred treatment of GST claims — Giving Crown priority over GST claims during CCAA proceedings but not in bankruptcy would reduce use of more flexible and responsive CCAA regime — Parliament likely inadvertently succumbed to drafting anomaly — Section 222(3) of ETA could not be seen as having impliedly repealed s. 18.3 of CCAA by its subsequent passage, given recent amendments to CCAA — Court had discretion under CCAA to construct bridge to liquidation under BIA, and partially lift stay of proceedings to allow entry into liquidation — No "gap" should exist when moving from CCAA to BIA — Court order segregating funds did not have certainty that Crown rather than creditor would be beneficiary sufficient to support express trust — Amount held in respect of GST debt was not subject to deemed trust, priority or express trust in favour of Crown — Excise Tax Act, R.S.C. 1985, c. E-15, ss. 222(1), (1.1).

Tax --- General principles — Priority of tax claims in bankruptcy proceedings

Debtor owed Crown under Excise Tax Act (ETA) for unremitted GST — Debtor sought relief under Companies' Creditors Arrangement Act (CCAA) — Under order of BC Supreme Court, amount of GST debt was placed in trust account and remaining proceeds of sale of assets paid to major secured creditor — Debtor's application for partial lifting of stay of proceedings to assign itself into bankruptcy was granted, while Crown's application for payment of tax debt was dismissed — Crown's appeal to BC Court of Appeal was allowed — Creditor appealed to Supreme Court of Canada — Appeal allowed — Analysis of ETA and CCAA yielded conclusion that CCAA provides that statutory deemed trusts do not apply, and that Parliament did not intend to restore Crown's deemed trust priority in GST claims under CCAA when it amended ETA in 2000 — Parliament had moved away from asserting priority for Crown claims under both CCAA and Bankruptcy and Insolvency Act (BIA), and neither statute provided for preferred treatment of GST claims — Giving Crown priority over GST claims during CCAA proceedings but not in bankruptcy would reduce use of more flexible and responsive CCAA regime — Parliament likely inadvertently succumbed to drafting anomaly — Section 222(3) of ETA could not be seen as having impliedly repealed s. 18.3 of CCAA by its subsequent passage, given recent amendments to CCAA — Court had discretion under CCAA to construct bridge to liquidation under BIA, and partially lift stay of proceedings to allow entry into liquidation — No "gap" should exist when moving from CCAA to BIA — Court order segregating funds did not have certainty that Crown rather than creditor would be beneficiary sufficient to support express trust — Amount held in respect of GST debt was not subject to deemed trust, priority or express trust in favour of Crown.

Taxation --- Taxe sur les produits et services — Perception et versement — Montant de TPS détenu en fiducie

Débitrice devait à la Couronne des montants de TPS qu'elle n'avait pas remis, en vertu de la Loi sur la taxe d'accise (LTA) — Débitrice a entamé des procédures judiciaires en vertu de la Loi sur les arrangements avec les créanciers des compagnies (LACC) — En vertu d'une ordonnance du tribunal, le montant de la créance fiscale a été déposé dans un compte en fiducie et la balance du produit de la vente des actifs a servi à payer le créancier garanti principal — Demande de la débitrice visant à obtenir la levée partielle de la suspension de procédures afin qu'elle puisse faire cession de ses biens a été accordée, alors que la demande de la Couronne visant à obtenir le paiement des montants de TPS non remis a été rejetée — Appel interjeté par la Couronne a été accueilli — Créancier a formé un pourvoi — Pourvoi accueilli — Analyse de la LTA et de la LACC conduisait à la conclusion que le législateur ne saurait avoir eu l'intention de redonner la priorité, dans le cadre de la LACC, à la fiducie réputée de la Couronne à l'égard de ses créances relatives à la TPS quand il a modifié la LTA, en 2000 — Législateur avait mis un terme à la priorité accordée aux créances de la Couronne sous les régimes de la LACC et de la Loi sur la faillite et l'insolvabilité (LFI), et ni l'une ni l'autre de ces lois ne prévoyaient que les créances relatives à la TPS bénéficiaient d'un traitement préférentiel — Fait de faire primer la priorité de la Couronne sur les créances découlant de la TPS dans le cadre de procédures fondées sur la LACC mais pas en cas de faillite aurait pour effet de restreindre le recours à la possibilité de se restructurer sous le régime plus souple et mieux adapté de la LACC — Il semblait probable que le législateur avait par inadvertance commis une anomalie rédactionnelle — On ne pourrait pas considérer l'art. 222(3) de la LTA comme ayant implicitement abrogé l'art. 18.3 de la LACC, compte tenu des modifications récemment apportées à la LACC — Sous le régime de la LACC, le tribunal avait discrétion pour établir une passerelle vers une liquidation opérée sous le régime de la LFI et de lever la suspension partielle des procédures afin de permettre à la débitrice de procéder à la transition au régime de liquidation — Il n'y avait aucune certitude, en vertu de l'ordonnance du tribunal, que la Couronne était le bénéficiaire véritable de la fiducie ni de fondement pour donner naissance à une fiducie expresse — Montant perçu au titre de la TPS ne faisait l'objet d'aucune fiducie présumée, priorité ou fiducie expresse en faveur de la Couronne.

Taxation --- Principes généraux — Priorité des créances fiscales dans le cadre de procédures en faillite

Débitrice devait à la Couronne des montants de TPS qu'elle n'avait pas remis, en vertu de la Loi sur la taxe d'accise (LTA) — Débitrice a entamé des procédures judiciaires en vertu de la Loi sur les arrangements avec les créanciers des compagnies (LACC) — En vertu d'une ordonnance du tribunal, le montant de la créance fiscale a été déposé dans un compte en fiducie et la balance du produit de la vente des actifs a servi à payer le créancier garanti principal

— Demande de la débitrice visant à obtenir la levée partielle de la suspension de procédures afin qu'elle puisse faire cession de ses biens a été accordée, alors que la demande de la Couronne visant à obtenir le paiement des montants de TPS non remis a été rejetée — Appel interjeté par la Couronne a été accueilli — Créancier a formé un pourvoi — Pourvoi accueilli — Analyse de la LTA et de la LACC conduisait à la conclusion que le législateur ne saurait avoir eu l'intention de redonner la priorité, dans le cadre de la LACC, à la fiducie réputée de la Couronne à l'égard de ses créances relatives à la TPS quand il a modifié la LTA, en 2000 — Législateur avait mis un terme à la priorité accordée aux créances de la Couronne sous les régimes de la LACC et de la Loi sur la faillite et l'insolvabilité (LFI), et ni l'une ni l'autre de ces lois ne prévoyaient que les créances relatives à la TPS bénéficiaient d'un traitement préférentiel — Fait de faire primer la priorité de la Couronne sur les créances découlant de la TPS dans le cadre de procédures fondées sur la LACC mais pas en cas de faillite aurait pour effet de restreindre le recours à la possibilité de se restructurer sous le régime plus souple et mieux adapté de la LACC — Il semblait probable que le législateur avait par inadvertance commis une anomalie rédactionnelle — On ne pourrait pas considérer l'art. 222(3) de la LTA comme ayant implicitement abrogé l'art. 18.3 de la LACC, compte tenu des modifications récemment apportées à la LACC — Sous le régime de la LACC, le tribunal avait discrétion pour établir une passerelle vers une liquidation opérée sous le régime de la LFI et de lever la suspension partielle des procédures afin de permettre à la débitrice de procéder à la transition au régime de liquidation — Il n'y avait aucune certitude, en vertu de l'ordonnance du tribunal, que la Couronne était le bénéficiaire véritable de la fiducie ni de fondement pour donner naissance à une fiducie expresse — Montant perçu au titre de la TPS ne faisait l'objet d'aucune fiducie présumée, priorité ou fiducie expresse en faveur de la Couronne.

The debtor company owed the Crown under the Excise Tax Act (ETA) for GST that was not remitted. The debtor commenced proceedings under the Companies' Creditors Arrangement Act (CCAA). Under an order by the B.C. Supreme Court, the amount of the tax debt was placed in a trust account, and the remaining proceeds from the sale of the debtor's assets were paid to the major secured creditor. The debtor's application for a partial lifting of the stay of proceedings in order to assign itself into bankruptcy was granted, while the Crown's application for the immediate payment of the unremitted GST was dismissed.

The Crown's appeal to the B.C. Court of Appeal was allowed. The Court of Appeal found that the lower court was bound by the ETA to give the Crown priority once bankruptcy was inevitable. The Court of Appeal ruled that there was a deemed trust under s. 222 of the ETA or that an express trust was created in the Crown's favour by the court order segregating the GST funds in the trust account.

The creditor appealed to the Supreme Court of Canada.

Held: The appeal was allowed.

Per Deschamps J. (McLachlin C.J.C., Binnie, LeBel, Charron, Rothstein, Cromwell JJ. concurring): A purposive and contextual analysis of the ETA and CCAA yielded the conclusion that Parliament could not have intended to restore the Crown's deemed trust priority in GST claims under the CCAA when it amended the ETA in 2000. Parliament had moved away from asserting priority for Crown claims in insolvency law under both the CCAA and Bankruptcy and Insolvency Act (BIA). Unlike for source deductions, there was no express statutory basis in the CCAA or BIA for concluding that GST claims enjoyed any preferential treatment. The internal logic of the CCAA also militated against upholding a deemed trust for GST claims.

Giving the Crown priority over GST claims during CCAA proceedings but not in bankruptcy would, in practice, deprive companies of the option to restructure under the more flexible and responsive CCAA regime. It seemed likely that Parliament had inadvertently succumbed to a drafting anomaly, which could be resolved by giving precedence to s. 18.3 of the CCAA. Section 222(3) of the ETA could no longer be seen as having impliedly repealed s. 18.3 of the CCAA by being passed subsequently to the CCAA, given the recent amendments to the CCAA. The legislative

context supported the conclusion that s. 222(3) of the ETA was not intended to narrow the scope of s. 18.3 of the CCAA.

The breadth of the court's discretion under the CCAA was sufficient to construct a bridge to liquidation under the BIA, so there was authority under the CCAA to partially lift the stay of proceedings to allow the debtor's entry into liquidation. There should be no gap between the CCAA and BIA proceedings that would invite a race to the courthouse to assert priorities.

The court order did not have the certainty that the Crown would actually be the beneficiary of the funds sufficient to support an express trust, as the funds were segregated until the dispute between the creditor and the Crown could be resolved. The amount collected in respect of GST but not yet remitted to the Receiver General of Canada was not subject to a deemed trust, priority or express trust in favour of the Crown.

Per Fish J. (concurring): Parliament had declined to amend the provisions at issue after detailed consideration of the insolvency regime, so the apparent conflict between s. 18.3 of the CCAA and s. 222 of the ETA should not be treated as a drafting anomaly. In the insolvency context, a deemed trust would exist only when two complementary elements co-existed: first, a statutory provision creating the trust; and second, a CCAA or BIA provision confirming its effective operation. Parliament had created the Crown's deemed trust in the Income Tax Act, Canada Pension Plan and Employment Insurance Act and then confirmed in clear and unmistakable terms its continued operation under both the CCAA and the BIA regimes. In contrast, the ETA created a deemed trust in favour of the Crown, purportedly notwithstanding any contrary legislation, but Parliament did not expressly provide for its continued operation in either the BIA or the CCAA. The absence of this confirmation reflected Parliament's intention to allow the deemed trust to lapse with the commencement of insolvency proceedings. Parliament's evident intent was to render GST deemed trusts inoperative upon the institution of insolvency proceedings, and so s. 222 of the ETA mentioned the BIA so as to exclude it from its ambit, rather than include it as the other statutes did. As none of these statutes mentioned the CCAA expressly, the specific reference to the BIA had no bearing on the interaction with the CCAA. It was the confirmatory provisions in the insolvency statutes that would determine whether a given deemed trust would subsist during insolvency proceedings.

Per Abella J. (dissenting): The appellate court properly found that s. 222(3) of the ETA gave priority during CCAA proceedings to the Crown's deemed trust in unremitted GST. The failure to exempt the CCAA from the operation of this provision was a reflection of clear legislative intent. Despite the requests of various constituencies and case law confirming that the ETA took precedence over the CCAA, there was no responsive legislative revision and the BIA remained the only exempted statute. There was no policy justification for interfering, through interpretation, with this clarity of legislative intention and, in any event, the application of other principles of interpretation reinforced this conclusion. Contrary to the majority's view, the "later in time" principle did not favour the precedence of the CCAA, as the CCAA was merely re-enacted without significant substantive changes. According to the Interpretation Act, in such circumstances, s. 222(3) of the ETA remained the later provision. The chambers judge was required to respect the priority regime set out in s. 222(3) of the ETA and so did not have the authority to deny the Crown's request for payment of the GST funds during the CCAA proceedings.

La compagnie débitrice devait à la Couronne des montants de TPS qu'elle n'avait pas remis, en vertu de la Loi sur la taxe d'accise (LTA). La débitrice a entamé des procédures judiciaires en vertu de la Loi sur les arrangements avec les créanciers des compagnies (LACC). En vertu d'une ordonnance du tribunal, le montant de la créance fiscale a été déposé dans un compte en fiducie et la balance du produit de la vente des actifs de la débitrice a servi à payer le créancier garanti principal. La demande de la débitrice visant à obtenir la levée partielle de la suspension de procédures afin qu'elle puisse faire cession de ses biens a été accordée, alors que la demande de la Couronne visant à obtenir le paiement immédiat des montants de TPS non remis a été rejetée.

L'appel interjeté par la Couronne a été accueilli. La Cour d'appel a conclu que le tribunal se devait, en vertu de la LTA, de donner priorité à la Couronne une fois la faillite inévitable. La Cour d'appel a estimé que l'art. 222 de la LTA établissait une fiducie présumée ou bien que l'ordonnance du tribunal à l'effet que les montants de TPS soient détenus dans un compte en fiducie créait une fiducie expresse en faveur de la Couronne.

Le créancier a formé un pourvoi.

Arrêt: Le pourvoi a été accueilli.

Deschamps, J. (McLachlin, J.C.C., Binnie, LeBel, Charron, Rothstein, Cromwell, JJ., souscrivant à son opinion) : Une analyse téléologique et contextuelle de la LTA et de la LACC conduisait à la conclusion que le législateur ne saurait avoir eu l'intention de redonner la priorité, dans le cadre de la LACC, à la fiducie réputée de la Couronne à l'égard de ses créances relatives à la TPS quand il a modifié la LTA, en 2000. Le législateur avait mis un terme à la priorité accordée aux créances de la Couronne dans le cadre du droit de l'insolvabilité, sous le régime de la LACC et celui de la Loi sur la faillite et l'insolvabilité (LFI). Contrairement aux retenues à la source, aucune disposition législative expresse ne permettait de conclure que les créances relatives à la TPS bénéficiaient d'un traitement préférentiel sous le régime de la LACC ou celui de la LFI. La logique interne de la LACC allait également à l'encontre du maintien de la fiducie réputée à l'égard des créances découlant de la TPS.

Le fait de faire primer la priorité de la Couronne sur les créances découlant de la TPS dans le cadre de procédures fondées sur la LACC mais pas en cas de faillite aurait pour effet, dans les faits, de priver les compagnies de la possibilité de se restructurer sous le régime plus souple et mieux adapté de la LACC. Il semblait probable que le législateur avait par inadvertance commis une anomalie rédactionnelle, laquelle pouvait être corrigée en donnant préséance à l'art. 18.3 de la LACC. On ne pouvait plus considérer l'art. 222(3) de la LTA comme ayant implicitement abrogé l'art. 18.3 de la LACC parce qu'il avait été adopté après la LACC, compte tenu des modifications récemment apportées à la LACC. Le contexte législatif étayait la conclusion suivant laquelle l'art. 222(3) de la LTA n'avait pas pour but de restreindre la portée de l'art. 18.3 de la LACC.

L'ampleur du pouvoir discrétionnaire conféré au tribunal par la LACC était suffisant pour établir une passerelle vers une liquidation opérée sous le régime de la LFI, de sorte qu'il avait, en vertu de la LACC, le pouvoir de lever la suspension partielle des procédures afin de permettre à la débitrice de procéder à la transition au régime de liquidation. Il n'y avait aucune certitude, en vertu de l'ordonnance du tribunal, que la Couronne était le bénéficiaire véritable de la fiducie ni de fondement pour donner naissance à une fiducie expresse, puisque les fonds étaient détenus à part jusqu'à ce que le litige entre le créancier et la Couronne soit résolu. Le montant perçu au titre de la TPS mais non encore versé au receveur général du Canada ne faisait l'objet d'aucune fiducie présumée, priorité ou fiducie expresse en faveur de la Couronne.

Fish, J. (souscrivant aux motifs des juges majoritaires) : Le législateur a refusé de modifier les dispositions en question suivant un examen approfondi du régime d'insolvabilité, de sorte qu'on ne devrait pas qualifier l'apparente contradiction entre l'art. 18.3 de la LACC et l'art. 222 de la LTA d'anomalie rédactionnelle. Dans un contexte d'insolvabilité, on ne pourrait conclure à l'existence d'une fiducie présumée que lorsque deux éléments complémentaires étaient réunis : en premier lieu, une disposition législative qui crée la fiducie et, en second lieu, une disposition de la LACC ou de la LFI qui confirme l'existence de la fiducie. Le législateur a établi une fiducie présumée en faveur de la Couronne dans la Loi de l'impôt sur le revenu, le Régime de pensions du Canada et la Loi sur l'assurance-emploi puis, il a confirmé en termes clairs et explicites sa volonté de voir cette fiducie présumée produire ses effets sous le régime de la LACC et de la LFI. Dans le cas de la LTA, il a établi une fiducie présumée en faveur de la Couronne, sciemment et sans égard pour toute législation à l'effet contraire, mais n'a pas expressément prévu le maintien en vigueur de celle-ci sous le régime de la LFI ou celui de la LACC. L'absence d'une telle confirmation

témoignait de l'intention du législateur de laisser la fiducie présumée devenir caduque au moment de l'introduction de la procédure d'insolvabilité. L'intention du législateur était manifestement de rendre inopérantes les fiducies présumées visant la TPS dès l'introduction d'une procédure d'insolvabilité et, par conséquent, l'art. 222 de la LTA mentionnait la LFI de manière à l'exclure de son champ d'application, et non de l'y inclure, comme le faisaient les autres lois. Puisqu'aucune de ces lois ne mentionnait spécifiquement la LACC, la mention explicite de la LFI n'avait aucune incidence sur l'interaction avec la LACC. C'était les dispositions confirmatoires que l'on trouvait dans les lois sur l'insolvabilité qui déterminaient si une fiducie présumée continuerait d'exister durant une procédure d'insolvabilité.

Abella, J. (dissidente) : La Cour d'appel a conclu à bon droit que l'art. 222(3) de la LTA donnait préséance à la fiducie présumée qui est établie en faveur de la Couronne à l'égard de la TPS non versée. Le fait que la LACC n'ait pas été soustraite à l'application de cette disposition témoignait d'une intention claire du législateur. Malgré les demandes répétées de divers groupes et la jurisprudence ayant confirmé que la LTA l'emportait sur la LACC, le législateur n'est pas intervenu et la LFI est demeurée la seule loi soustraite à l'application de cette disposition. Il n'y avait pas de considération de politique générale qui justifierait d'aller à l'encontre, par voie d'interprétation législative, de l'intention aussi clairement exprimée par le législateur et, de toutes manières, cette conclusion était renforcée par l'application d'autres principes d'interprétation. Contrairement à l'opinion des juges majoritaires, le principe de la préséance de la « loi postérieure » ne militait pas en faveur de la présance de la LACC, celle-ci ayant été simplement adoptée à nouveau sans que l'on ne lui ait apporté de modifications importantes. En vertu de la Loi d'interprétation, dans ces circonstances, l'art. 222(3) de la LTA demeurait la disposition postérieure. Le juge siégeant en son cabinet était tenu de respecter le régime de priorités établi à l'art. 222(3) de la LTA, et il ne pouvait pas refuser la demande présentée par la Couronne en vue de se faire payer la TPS dans le cadre de la procédure introduite en vertu de la LACC.

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Royal Bank v. Sparrow Electric Corp. (1997), 193 A.R. 321, 135 W.A.C. 321, [1997] 2 W.W.R. 457, 208 N.R. 161, 12 P.P.S.A.C. (2d) 68, 1997 CarswellAlta 112, 1997 CarswellAlta 113, 46 Alta. L.R. (3d) 87, (sub nom. *R. v. Royal Bank)* 97 D.T.C. 5089, 143 D.L.R. (4th) 385, 44 C.B.R. (3d) 1, [1997] 1 S.C.R. 411 (S.C.C.) — considered

Skeena Cellulose Inc., Re (2003), 2003 CarswellBC 1399, 2003 BCCA 344, 184 B.C.A.C. 54, 302 W.A.C. 54, 43 C.B.R. (4th) 187, 13 B.C.L.R. (4th) 236 (B.C. C.A.) — referred to

Skydome Corp., Re (1998), 16 C.B.R. (4th) 118, 1998 CarswellOnt 5922 (Ont. Gen. Div. [Commercial List]) — referred to

Solid Resources Ltd., Re (2002), [2003] G.S.T.C. 21, 2002 CarswellAlta 1699, 40 C.B.R. (4th) 219 (Alta. Q.B.) — referred to

Stelco Inc., Re (2005), 253 D.L.R. (4th) 109, 75 O.R. (3d) 5, 2 B.L.R. (4th) 238, 9 C.B.R. (5th) 135, 2005 CarswellOnt 1188, 196 O.A.C. 142 (Ont. C.A.) — referred to

United Used Auto & Truck Parts Ltd., Re (1999), 12 C.B.R. (4th) 144, 1999 CarswellBC 2673 (B.C. S.C. [In Chambers]) — referred to

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Ottawa Senators Hockey Club Corp., Re (2005), 2005 G.T.C. 1327 (Eng.), 6 C.B.R. (5th) 293, 2005 D.T.C. 5233 (Eng.), 2005 CarswellOnt 8, [2005] G.S.T.C. 1, 193 O.A.C. 95, 73 O.R. (3d) 737 (Ont. C.A.) — not followed

Cases considered by *Abella J.* (dissenting):

Canada (Attorney General) v. Canada (Public Service Staff Relations Board) (1977), [1977] 2 F.C. 663, 14 N.R. 257, 74 D.L.R. (3d) 307, 1977 CarswellNat 62, 1977 CarswellNat 62F (Fed. C.A.) — referred to

Doré c. Verdun (Municipalité) (1997), (sub nom. *Doré v. Verdun (City))* [1997] 2 S.C.R. 862, (sub nom. *Doré v. Verdun (Ville))* 215 N.R. 81, (sub nom. *Doré v. Verdun (City))* 150 D.L.R. (4th) 385, 1997 CarswellQue 159, 1997 CarswellQue 850 (S.C.C.) — referred to

Ottawa Senators Hockey Club Corp., Re (2005), 2005 G.T.C. 1327 (Eng.), 6 C.B.R. (5th) 293, 2005 D.T.C. 5233 (Eng.), 2005 CarswellOnt 8, [2005] G.S.T.C. 1, 193 O.A.C. 95, 73 O.R. (3d) 737 (Ont. C.A.) — considered

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Statutes considered by *Deschamps J.*:

Bank Act, S.C. 1991, c. 46
Generally — referred to

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

s. 67(2) — referred to

s. 67(3) — referred to

s. 81.1 [en. 1992, c. 27, s. 38(1)] — considered

s. 81.2 [en. 1992, c. 27, s. 38(1)] — considered

s. 86(1) — considered

s. 86(3) — referred to

Bankruptcy Act and to amend the Income Tax Act in consequence thereof, Act to amend the, S.C. 1992, c. 27
Generally — referred to

s. 39 — referred to

Bankruptcy and Insolvency Act, the Companies' Creditors Arrangement Act and the Income Tax Act, Act to amend the, S.C. 1997, c. 12
s. 73 — referred to

s. 125 — referred to

s. 126 — referred to

Canada Pension Plan, R.S.C. 1985, c. C-8
Generally — referred to

s. 23(3) — referred to

s. 23(4) — referred to

Cités et villes, Loi sur les, L.R.Q., c. C-19
en général — referred to

Code civil du Québec, L.Q. 1991, c. 64
en général — referred to

art. 2930 — referred to

Companies' Creditors Arrangement Act, Act to Amend, S.C. 1952-53, c. 3
Generally — referred to

Companies' Creditors Arrangement Act, 1933, S.C. 1932-33, c. 36
Generally — referred to

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

s. 11 — considered

s. 11(1) — considered

s. 11(3) — referred to

s. 11(4) — referred to

s. 11(6) — referred to

s. 11.02 [en. 2005, c. 47, s. 128] — referred to

s. 11.09 [en. 2005, c. 47, s. 128] — considered

s. 11.4 [en. 1997, c. 12, s. 124] — referred to

s. 18.3 [en. 1997, c. 12, s. 125] — considered

s. 18.3(1) [en. 1997, c. 12, s. 125] — considered

s. 18.3(2) [en. 1997, c. 12, s. 125] — considered

s. 18.4 [en. 1997, c. 12, s. 125] — referred to

s. 18.4(1) [en. 1997, c. 12, s. 125] — considered

s. 18.4(3) [en. 1997, c. 12, s. 125] — considered

s. 20 — considered

s. 21 — considered

s. 37 — considered

s. 37(1) — referred to

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

s. 86(2) — referred to

s. 86(2.1) [en. 1998, c. 19, s. 266(1)] — referred to

Excise Tax Act, R.S.C. 1985, c. E-15
Generally — referred to

s. 222(1) [en. 1990, c. 45, s. 12(1)] — referred to

s. 222(3) [en. 1990, c. 45, s. 12(1)] — considered

Fairness for the Self-Employed Act, S.C. 2009, c. 33
Generally — referred to

Income Tax Act, R.S.C. 1985, c. 1 (5th Supp.)
s. 227(4) — referred to

s. 227(4.1) [en. 1998, c. 19, s. 226(1)] — referred to

Interpretation Act, R.S.C. 1985, c. I-21
s. 44(f) — considered

Personal Property Security Act, S.A. 1988, c. P-4.05
Generally — referred to

Sales Tax and Excise Tax Amendments Act, 1999, S.C. 2000, c. 30
Generally — referred to

Wage Earner Protection Program Act, S.C. 2005, c. 47, s. 1
Generally — referred to

s. 69 — referred to

s. 128 — referred to

s. 131 — referred to

Statutes considered *Fish J.*:

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

s. 67(2) — considered

s. 67(3) — considered

Canada Pension Plan, R.S.C. 1985, c. C-8
Generally — referred to

s. 23 — considered

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

s. 11 — considered

s. 18.3(1) [en. 1997, c. 12, s. 125] — considered

s. 18.3(2) [en. 1997, c. 12, s. 125] — considered

s. 37(1) — considered

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

s. 86(2) — referred to

s. 86(2.1) [en. 1998, c. 19, s. 266(1)] — referred to

Excise Tax Act, R.S.C. 1985, c. E-15
Generally — referred to

s. 222 [en. 1990, c. 45, s. 12(1)] — considered

s. 222(1) [en. 1990, c. 45, s. 12(1)] — considered

s. 222(3) [en. 1990, c. 45, s. 12(1)] — considered

s. 222(3)(a) [en. 1990, c. 45, s. 12(1)] — considered

Income Tax Act, R.S.C. 1985, c. 1 (5th Supp.)
Generally — referred to

s. 227(4) — considered

s. 227(4.1) [en. 1998, c. 19, s. 226(1)] — considered

s. 227(4.1)(a) [en. 1998, c. 19, s. 226(1)] — considered

Statutes considered *Abella J.* (dissenting):

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

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

s. 11 — considered

s. 11(1) — considered

s. 11(3) — considered

s. 18.3(1) [en. 1997, c. 12, s. 125] — considered

s. 37(1) — considered

Excise Tax Act, R.S.C. 1985, c. E-15
Generally — referred to

s. 222 [en. 1990, c. 45, s. 12(1)] — considered

s. 222(3) [en. 1990, c. 45, s. 12(1)] — considered

Interpretation Act, R.S.C. 1985, c. I-21

s. 2(1)"enactment" — considered

s. 44(f) — considered

Winding-up and Restructuring Act, R.S.C. 1985, c. W-11
Generally — referred to

APPEAL by creditor from judgment reported at 2009 CarswellBC 1195, 2009 BCCA 205, [2009] G.S.T.C. 79, 98 B.C.L.R. (4th) 242, [2009] 12 W.W.R. 684, 270 B.C.A.C. 167, 454 W.A.C. 167, 2009 G.T.C. 2020 (Eng.) (B.C. C.A.), allowing Crown's appeal from dismissal of application for immediate payment of tax debt.

***Deschamps J.*:**

1 For the first time this Court is called upon to directly interpret the provisions of the *Companies' Creditors Arrangement Act*, R.S.C. 1985, c. C-36 ("*CCAA*"). In that respect, two questions are raised. The first requires reconciliation of provisions of the *CCAA* and the *Excise Tax Act*, R.S.C. 1985, c. E-15 ("*ETA*"), which lower courts have held to be in conflict with one another. The second concerns the scope of a court's discretion when supervising reorganization. The relevant statutory provisions are reproduced in the Appendix. On the first question, having considered the evolution of Crown priorities in the context of insolvency and the wording of the various statutes creating Crown priorities, I conclude that it is the *CCAA* and not the *ETA* that provides the rule. On the second question, I conclude that the broad discretionary jurisdiction conferred on the supervising judge must be interpreted having regard to the remedial nature of the *CCAA* and insolvency legislation generally. Consequently, the court had the discretion to partially lift a stay of proceedings to allow the debtor to make an assignment under the *Bankruptcy and Insolvency Act*, R.S.C. 1985, c. B-3 ("*BIA*"). I would allow the appeal.

1. Facts and Decisions of the Courts Below

2 Ted LeRoy Trucking Ltd. ("LeRoy Trucking") commenced proceedings under the *CCAA* in the Supreme Court of British Columbia on December 13, 2007, obtaining a stay of proceedings with a view to reorganizing its financial affairs. LeRoy Trucking sold certain redundant assets as authorized by the order.

3 Amongst the debts owed by LeRoy Trucking was an amount for Goods and Services Tax ("GST") collected but unremitted to the Crown. The *ETA* creates a deemed trust in favour of the Crown for amounts collected in respect of GST. The deemed trust extends to any property or proceeds held by the person collecting GST and any property of that person held by a secured creditor, requiring that property to be paid to the Crown in priority to all security interests. The *ETA* provides that the deemed trust operates despite any other enactment of Canada except the *BIA*. However, the *CCAA* also provides that subject to certain exceptions, none of which mentions GST, deemed trusts in favour of the Crown do not operate under the *CCAA*. Accordingly, under the *CCAA* the Crown ranks as an unsecured creditor in respect of GST. Nonetheless, at the time LeRoy Trucking commenced *CCAA* proceedings the leading line of jurisprudence held that the *ETA* took precedence over the *CCAA* such that the Crown enjoyed priority for GST claims under the *CCAA*, even though it would have lost that same priority under the *BIA*. The *CCAA* underwent substantial amendments in 2005 in which some of the provisions at issue in this appeal were renumbered and reformulated (S.C. 2005, c. 47). However, these amendments only came into force on September 18, 2009. I will refer to the amended provisions only where relevant.

4 On April 29, 2008, Brenner C.J.S.C., in the context of the *CCAA* proceedings, approved a payment not exceeding $5 million, the proceeds of redundant asset sales, to Century Services, the debtor's major secured creditor. LeRoy Trucking proposed to hold back an amount equal to the GST monies collected but unremitted to the Crown and place it in the Monitor's trust account until the outcome of the reorganization was known. In order to maintain the *status quo* while the success of the reorganization was uncertain, Brenner C.J.S.C. agreed to the proposal and ordered that an amount of $305,202.30 be held by the Monitor in its trust account.

5 On September 3, 2008, having concluded that reorganization was not possible, LeRoy Trucking sought leave to make an assignment in bankruptcy under the *BIA*. The Crown sought an order that the GST monies held by the Monitor be paid to the Receiver General of Canada. Brenner C.J.S.C. dismissed the latter application. Reasoning that the purpose of segregating the funds with the Monitor was "to facilitate an ultimate payment of the GST monies which were owed pre-filing, but only if a viable plan emerged", the failure of such a reorganization, followed by an assignment in bankruptcy, meant the Crown would lose priority under the *BIA* (2008 BCSC 1805, [2008] G.S.T.C. 221 (B.C. S.C. [In Chambers])).

6 The Crown's appeal was allowed by the British Columbia Court of Appeal (2009 BCCA 205, [2009] G.S.T.C. 79, 270 B.C.A.C. 167 (B.C. C.A.)). Tysoe J.A. for a unanimous court found two independent bases for allowing the Crown's appeal.

7 First, the court's authority under s. 11 of the *CCAA* was held not to extend to staying the Crown's application for immediate payment of the GST funds subject to the deemed trust after it was clear that reorganization efforts had failed and that bankruptcy was inevitable. As restructuring was no longer a possibility, staying the Crown's claim to the GST funds no longer served a purpose under the *CCAA* and the court was bound under the priority scheme provided by the *ETA* to allow payment to the Crown. In so holding, Tysoe J.A. adopted the reasoning in *Ottawa Senators Hockey Club Corp. (Re)*, [2005] G.S.T.C. 1, 73 O.R. (3d) 737 (Ont. C.A.), which found that the *ETA* deemed trust for GST established Crown priority over secured creditors under the *CCAA*.

8 Second, Tysoe J.A. concluded that by ordering the GST funds segregated in the Monitor's trust account on April 29, 2008, the judge had created an express trust in favour of the Crown from which the monies in question could not be diverted for any other purposes. The Court of Appeal therefore ordered that the money held by the Monitor in trust be paid to the Receiver General.

2. Issues

9 This appeal raises three broad issues which are addressed in turn:

(1) Did s. 222(3) of the *ETA* displace s. 18.3(1) of the *CCAA* and give priority to the Crown's *ETA* deemed trust during *CCAA* proceedings as held in *Ottawa Senators*?

(2) Did the court exceed its *CCAA* authority by lifting the stay to allow the debtor to make an assignment in bankruptcy?

(3) Did the court's order of April 29, 2008 requiring segregation of the Crown's GST claim in the Monitor's trust account create an express trust in favour of the Crown in respect of those funds?

3. Analysis

10 The first issue concerns Crown priorities in the context of insolvency. As will be seen, the *ETA* provides for a deemed trust in favour of the Crown in respect of GST owed by a debtor "[d]espite ... any other enactment of Canada (except the *Bankruptcy and Insolvency Act*)" (s. 222(3)), while the *CCAA* stated at the relevant time that "notwithstanding any provision in federal or provincial legislation that has the effect of deeming property to be held in trust for Her Majesty, property of a debtor company shall not be [so] regarded" (s. 18.3(1)). It is difficult to imagine two statutory provisions more apparently in conflict. However, as is often the case, the apparent conflict can be resolved through interpretation.

11 In order to properly interpret the provisions, it is necessary to examine the history of the *CCAA*, its function amidst the body of insolvency legislation enacted by Parliament, and the principles that have been recognized in the jurisprudence. It will be seen that Crown priorities in the insolvency context have been significantly pared down. The resolution of the second issue is also rooted in the context of the *CCAA*, but its purpose and the manner in which it has been interpreted in the case law are also key. After examining the first two issues in this case, I will address Tysoe J.A.'s conclusion that an express trust in favour of the Crown was created by the court's order of April 29, 2008.

3.1 Purpose and Scope of Insolvency Law

12 Insolvency is the factual situation that arises when a debtor is unable to pay creditors (see generally, R. J. Wood, *Bankruptcy and Insolvency Law* (2009), at p. 16). Certain legal proceedings become available upon insolvency, which typically allow a debtor to obtain a court order staying its creditors' enforcement actions and attempt to obtain a binding compromise with creditors to adjust the payment conditions to something more realistic. Alternatively, the debtor's assets may be liquidated and debts paid from the proceeds according to statutory priority rules. The former is usually referred to as reorganization or restructuring while the latter is termed liquidation.

13 Canadian commercial insolvency law is not codified in one exhaustive statute. Instead, Parliament has enacted multiple insolvency statutes, the main one being the *BIA*. The *BIA* offers a self-contained legal regime providing for both reorganization and liquidation. Although bankruptcy legislation has a long history, the *BIA* itself is a fairly recent statute — it was enacted in 1992. It is characterized by a rules-based approach to proceedings. The *BIA* is available to insolvent debtors owing $1000 or more, regardless of whether they are natural or legal persons. It contains mechanisms for debtors to make proposals to their creditors for the adjustment of debts. If a proposal fails, the *BIA* contains a bridge to bankruptcy whereby the debtor's assets are liquidated and the proceeds paid to creditors in accordance with the statutory scheme of distribution.

14 Access to the *CCAA* is more restrictive. A debtor must be a company with liabilities in excess of $5 million. Unlike the *BIA*, the *CCAA* contains no provisions for liquidation of a debtor's assets if reorganization fails. There are three ways of exiting *CCAA* proceedings. The best outcome is achieved when the stay of proceedings provides the debtor with some breathing space during which solvency is restored and the *CCAA* process terminates without reorganization being needed. The second most desirable outcome occurs when the debtor's compromise or arrangement is accepted by its creditors and the reorganized company emerges from the *CCAA* proceedings as a going concern. Lastly, if the compromise or arrangement fails, either the company or its creditors usually seek to have the debtor's assets liquidated under the applicable provisions of the *BIA* or to place the debtor into receivership. As discussed in greater detail below, the key difference between the reorganization regimes under the *BIA* and the *CCAA* is that the latter offers a more flexible mechanism with greater judicial discretion, making it more responsive to complex reorganizations.

15 As I will discuss at greater length below, the purpose of the *CCAA* — Canada's first reorganization statute — is to permit the debtor to continue to carry on business and, where possible, avoid the social and economic costs of liquidating its assets. Proposals to creditors under the *BIA* serve the same remedial purpose, though this is achieved through a rules-based mechanism that offers less flexibility. Where reorganization is impossible, the *BIA* may be employed to provide an orderly mechanism for the distribution of a debtor's assets to satisfy creditor claims according to predetermined priority rules.

16 Prior to the enactment of the *CCAA* in 1933 (S.C. 1932-33, c. 36), practice under existing commercial insolvency legislation tended heavily towards the liquidation of a debtor company (J. Sarra, *Creditor Rights and the Public Interest: Restructuring Insolvent Corporations* (2003), at p. 12). The battering visited upon Canadian businesses by the Great Depression and the absence of an effective mechanism for reaching a compromise between debtors and creditors to avoid liquidation required a legislative response. The *CCAA* was innovative as it allowed the insolvent debtor to attempt reorganization under judicial supervision outside the existing insolvency legislation which, once engaged, almost invariably resulted in liquidation (*Reference re Companies' Creditors Arrangement Act (Canada)*, [1934] S.C.R. 659 (S.C.C.), at pp. 660-61; Sarra, *Creditor Rights*, at pp. 12-13).

17 Parliament understood when adopting the *CCAA* that liquidation of an insolvent company was harmful for most of those it affected — notably creditors and employees — and that a workout which allowed the company to survive was optimal (Sarra, *Creditor Rights*, at pp. 13-15).

18 Early commentary and jurisprudence also endorsed the *CCAA's* remedial objectives. It recognized that companies retain more value as going concerns while underscoring that intangible losses, such as the evaporation of the companies' goodwill, result from liquidation (S. E. Edwards, "Reorganizations Under the Companies' Creditors Arrangement Act" (1947), 25 *Can. Bar Rev.* 587, at p. 592). Reorganization serves the public interest by facilitating the survival of companies supplying goods or services crucial to the health of the economy or saving large numbers of jobs (*ibid.*, at p. 593). Insolvency could be so widely felt as to impact stakeholders other than creditors and employees. Variants of these views resonate today, with reorganization justified in terms of rehabilitating companies that are key elements in a complex web of interdependent economic relationships in order to avoid the negative consequences of liquidation.

19 The *CCAA* fell into disuse during the next several decades, likely because amendments to the Act in 1953 restricted its use to companies issuing bonds (S.C. 1952-53, c. 3). During the economic downturn of the early 1980s, insolvency lawyers and courts adapting to the resulting wave of insolvencies resurrected the statute and deployed it in response to new economic challenges. Participants in insolvency proceedings grew to recognize and appreciate the statute's distinguishing feature: a grant of broad and flexible authority to the supervising court to make the orders necessary to facilitate the reorganization of the debtor and achieve the *CCAA's* objectives. The manner in which courts have used *CCAA* jurisdiction in increasingly creative and flexible ways is explored in greater detail below.

20 Efforts to evolve insolvency law were not restricted to the courts during this period. In 1970, a government-commissioned panel produced an extensive study recommending sweeping reform but Parliament failed to act (see *Bankruptcy and Insolvency: Report of the Study Committee on Bankruptcy and Insolvency Legislation* (1970)). Another panel of experts produced more limited recommendations in 1986 which eventually resulted in enactment of the *Bankruptcy and Insolvency Act* of 1992 (S.C. 1992, c. 27) (see *Proposed Bankruptcy Act Amendments: Report of the Advisory Committee on Bankruptcy and Insolvency* (1986)). Broader provisions for reorganizing insolvent debtors were then included in Canada's bankruptcy statute. Although the 1970 and 1986 reports made no specific recommendations with respect to the *CCAA*, the House of Commons committee studying the *BIA*'s predecessor bill, C-22, seemed to accept expert testimony that the *BIA*'s new reorganization scheme would shortly supplant the *CCAA*, which could then be repealed, with commercial insolvency and bankruptcy being governed by a single statute (*Minutes of Proceedings and Evidence of the Standing Committee on Consumer and Corporate Affairs and Government Operations*, Issue No. 15, October 3, 1991, at pp. 15:15-15:16).

21 In retrospect, this conclusion by the House of Commons committee was out of step with reality. It overlooked the renewed vitality the *CCAA* enjoyed in contemporary practice and the advantage that a flexible judicially supervised reorganization process presented in the face of increasingly complex reorganizations, when compared to the stricter rules-based scheme contained in the *BIA*. The "flexibility of the *CCAA* [was seen as] a great benefit, allowing for creative and effective decisions" (Industry Canada, Marketplace Framework Policy Branch, *Report on the Operation and Administration of the Bankruptcy and Insolvency Act and the Companies' Creditors Arrangement Act* (2002), at p. 41). Over the past three decades, resurrection of the *CCAA* has thus been the mainspring of a process through which, one author concludes, "the legal setting for Canadian insolvency restructuring has evolved from a rather blunt instrument to one of the most sophisticated systems in the developed world" (R. B. Jones, "The Evolution of Canadian Restructuring: Challenges for the Rule of Law", in J. P. Sarra, ed., *Annual Review of Insolvency Law 2005* (2006), 481, at p. 481).

22 While insolvency proceedings may be governed by different statutory schemes, they share some commonalities. The most prominent of these is the single proceeding model. The nature and purpose of the single proceeding model are described by Professor Wood in *Bankruptcy and Insolvency Law*:

> They all provide a collective proceeding that supersedes the usual civil process available to creditors to enforce their claims. The creditors' remedies are collectivized in order to prevent the free-for-all that would otherwise prevail if creditors were permitted to exercise their remedies. In the absence of a collective process, each creditor is armed with the knowledge that if they do not strike hard and swift to seize the debtor's assets, they will be beat out by other creditors. [pp. 2-3]

The single proceeding model avoids the inefficiency and chaos that would attend insolvency if each creditor initiated proceedings to recover its debt. Grouping all possible actions against the debtor into a single proceeding controlled in a single forum facilitates negotiation with creditors because it places them all on an equal footing, rather than exposing them to the risk that a more aggressive creditor will realize its claims against the debtor's limited assets while the other creditors attempt a compromise. With a view to achieving that purpose, both the *CCAA* and the *BIA* allow a court to order all actions against a debtor to be stayed while a compromise is sought.

23 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. In addition, one of the important features of legislative reform of both statutes since the enactment of the *BIA* in 1992 has been a cutback in Crown priorities (S.C. 1992, c. 27, s. 39; S.C. 1997, c. 12, ss. 73 and 125; S.C. 2000, c. 30, s. 148; S.C. 2005, c. 47, ss. 69 and 131; S.C. 2009, c. 33, ss. 25 and 29; see also *Alternative granite & marbre inc., Re*, 2009 SCC 49, [2009] 3 S.C.R. 286, [2009] G.S.T.C. 154 (S.C.C.); *Quebec (Deputy Minister of Revenue) c. Rainville* (1979), [1980] 1 S.C.R. 35 (S.C.C.); *Proposed Bankruptcy Act Amendments: Report of the Advisory Committee on Bankruptcy and Insolvency* (1986)).

24 With parallel *CCAA* and *BIA* restructuring schemes now an accepted feature of the insolvency law landscape, the contemporary thrust of legislative reform has been towards harmonizing aspects of insolvency law common to the two statutory schemes to the extent possible and encouraging reorganization over liquidation (see *An Act to establish the Wage Earner Protection Program Act, to amend the Bankruptcy and Insolvency Act and the Companies' Creditors Arrangement Act and to make consequential amendments to other Acts*, S.C. 2005, c. 47; *Gauntlet Energy Corp., Re*, 2003 ABQB 894, [2003] G.S.T.C. 193, 30 Alta. L.R. (4th) 192 (Alta. Q.B.), at para. 19).

25 Mindful of the historical background of the *CCAA* and *BIA*, I now turn to the first question at issue.

3.2 GST Deemed Trust Under the CCAA

26 The Court of Appeal proceeded on the basis that the *ETA* precluded the court from staying the Crown's enforcement of the GST deemed trust when partially lifting the stay to allow the debtor to enter bankruptcy. In so doing, it adopted the reasoning in a line of cases culminating in *Ottawa Senators*, which held that an *ETA* deemed trust remains enforceable during *CCAA* reorganization despite language in the *CCAA* that suggests otherwise.

27 The Crown relies heavily on the decision of the Ontario Court of Appeal in *Ottawa Senators* and argues that the later in time provision of the *ETA* creating the GST deemed trust trumps the provision of the *CCAA* purporting to nullify most statutory deemed trusts. The Court of Appeal in this case accepted this reasoning but not all provincial courts follow it (see, e.g., *Komunik Corp., Re*, 2009 QCCS 6332 (C.S. Que.), leave to appeal granted, 2010 QCCA 183 (C.A. Que.)). Century Services relied, in its written submissions to this Court, on the argument that the court had authority under the *CCAA* to continue the stay against the Crown's claim for unremitted GST. In oral argument, the question of whether *Ottawa Senators* was correctly decided nonetheless arose. After the hearing, the parties were asked to make further written submissions on this point. As appears evident from the reasons of my colleague Abella J., this issue has become prominent before this Court. In those circumstances, this Court needs to determine the correctness of the reasoning in *Ottawa Senators*.

28 The policy backdrop to this question involves the Crown's priority as a creditor in insolvency situations which, as I mentioned above, has evolved considerably. Prior to the 1990s, Crown claims largely enjoyed priority in insolvency. This was widely seen as unsatisfactory as shown by both the 1970 and 1986 insolvency reform proposals, which recommended that Crown claims receive no preferential treatment. A closely related matter was whether the *CCAA* was binding at all upon the Crown. Amendments to the *CCAA* in 1997 confirmed that it did indeed bind the Crown (see *CCAA*, s. 21, as am. by S.C. 1997, c. 12, s. 126).

29 Claims of priority by the state in insolvency situations receive different treatment across jurisdictions worldwide. For example, in Germany and Australia, the state is given no priority at all, while the state enjoys wide priority in the United States and France (see B. K. Morgan, "Should the Sovereign be Paid First? A Comparative International Analysis of the Priority for Tax Claims in Bankruptcy" (2000), 74 *Am. Bank. L.J.* 461, at p. 500). Canada adopted a middle course through legislative reform of Crown priority initiated in 1992. The Crown retained priority for source deductions of income tax, Employment Insurance ("EI") and Canada Pension Plan ("CPP") premiums, but ranks as an ordinary unsecured creditor for most other claims.

30 Parliament has frequently enacted statutory mechanisms to secure Crown claims and permit their enforcement. The two most common are statutory deemed trusts and powers to garnish funds third parties owe the debtor (see F. L. Lamer, *Priority of Crown Claims in Insolvency* (loose-leaf), at § 2).

31 With respect to GST collected, Parliament has enacted a deemed trust. The *ETA* states that every person who collects an amount on account of GST is deemed to hold that amount in trust for the Crown (s. 222(1)). The deemed trust extends to other property of the person collecting the tax equal in value to the amount deemed to be in trust if that amount has not been remitted in accordance with the *ETA*. The deemed trust also extends to property held by a secured creditor that, but for the security interest, would be property of the person collecting the tax (s. 222(3)).

32 Parliament has created similar deemed trusts using almost identical language in respect of source deductions of income tax, EI premiums and CPP premiums (see s. 227(4) of the *Income Tax Act*, R.S.C. 1985, c. 1 (5th Supp.) ("*ITA*"), ss. 86(2) and (2.1) of the *Employment Insurance Act*, S.C. 1996, c. 23, and ss. 23(3) and (4) of the *Canada Pension Plan*, R.S.C. 1985, c. C-8). I will refer to income tax, EI and CPP deductions as "source deductions".

33 In *Royal Bank v. Sparrow Electric Corp.*, [1997] 1 S.C.R. 411 (S.C.C.), this Court addressed a priority dispute between a deemed trust for source deductions under the *ITA* and security interests taken under both the *Bank Act*, S.C. 1991, c. 46, and the Alberta *Personal Property Security Act*, S.A. 1988, c. P-4.05 ("*PPSA*"). As then worded, an *ITA* deemed trust over the debtor's property equivalent to the amount owing in respect of income tax became effective at the time of liquidation, receivership, or assignment in bankruptcy. *Sparrow Electric* held that the *ITA* deemed trust could not prevail over the security interests because, being fixed charges, the latter attached as soon as the debtor acquired rights in the property such that the *ITA* deemed trust had no property on which to attach when it subsequently arose. Later, in *First Vancouver Finance v. Minister of National Revenue*, 2002 SCC 49, [2002] G.S.T.C. 23, [2002] 2 S.C.R. 720 (S.C.C.), this Court observed that Parliament had legislated to strengthen the statutory deemed trust in the *ITA* by deeming it to operate from the moment the deductions were not paid to the Crown as required by the *ITA*, and by granting the Crown priority over all security interests (paras. 27-29) (the "*Sparrow Electric* amendment").

34 The amended text of s. 227(4.1) of the *ITA* and concordant source deductions deemed trusts in the *Canada Pension Plan* and the *Employment Insurance Act* state that the deemed trust operates notwithstanding any other enactment of Canada, except ss. 81.1 and 81.2 of the *BIA*. The *ETA* deemed trust at issue in this case is similarly worded, but it excepts the *BIA* in its entirety. The provision reads as follows:

> **222.** (3) Despite any other provision of this Act (except subsection (4)), any other enactment of Canada (except the *Bankruptcy and Insolvency Act)*, any enactment of a province or any other law, if at any time an amount deemed by subsection (1) to be held by a person in trust for Her Majesty is not remitted to the Receiver General or withdrawn in the manner and at the time provided under this Part, property of the person and property held by any secured creditor of the person that, but for a security interest, would be property of the person, equal in value to the amount so deemed to be held in trust, is deemed ....

35 The Crown submits that the *Sparrow Electric* amendment, added by Parliament to the *ETA* in 2000, was intended to preserve the Crown's priority over collected GST under the *CCAA* while subordinating the Crown to the status of an

unsecured creditor in respect of GST only under the *BIA*. This is because the *ETA* provides that the GST deemed trust is effective "despite" any other enactment except the *BIA*.

36 The language used in the *ETA* for the GST deemed trust creates an apparent conflict with the *CCAA*, which provides that subject to certain exceptions, property deemed by statute to be held in trust for the Crown shall not be so regarded.

37 Through a 1997 amendment to the *CCAA* (S.C. 1997, c. 12, s. 125), Parliament appears to have, subject to specific exceptions, nullified deemed trusts in favour of the Crown once reorganization proceedings are commenced under the Act. The relevant provision reads:

> **18.3** (1) Subject to subsection (2), notwithstanding any provision in federal or provincial legislation that has the effect of deeming property to be held in trust for Her Majesty, property of a debtor company shall not be regarded as held in trust for Her Majesty unless it would be so regarded in the absence of that statutory provision.

This nullification of deemed trusts was continued in further amendments to the *CCAA* (S.C. 2005, c. 47), where s. 18.3(1) was renumbered and reformulated as s. 37(1):

> **37.** (1) Subject to subsection (2), despite any provision in federal or provincial legislation that has the effect of deeming property to be held in trust for Her Majesty, property of a debtor company shall not be regarded as being held in trust for Her Majesty unless it would be so regarded in the absence of that statutory provision.

38 An analogous provision exists in the *BIA*, which, subject to the same specific exceptions, nullifies statutory deemed trusts and makes property of the bankrupt that would otherwise be subject to a deemed trust part of the debtor's estate and available to creditors (S.C. 1992, c. 27, s. 39; S.C. 1997, c. 12, s. 73; *BIA*, s. 67(2)). It is noteworthy that in both the *CCAA* and the *BIA*, the exceptions concern source deductions (*CCAA*, s. 18.3(2); *BIA*, s. 67(3)). The relevant provision of the *CCAA* reads:

> **18.3** (2) Subsection (1) does not apply in respect of amounts deemed to be held in trust under subsection 227(4) or (4.1) of the *Income Tax Act*, subsection 23(3) or (4) of the *Canada Pension Plan* or subsection 86(2) or (2.1) of the *Employment Insurance Act*....

Thus, the Crown's deemed trust and corresponding priority in source deductions remain effective both in reorganization and in bankruptcy.

39 Meanwhile, in both s. 18.4(1) of the *CCAA* and s. 86(1) of the *BIA*, other Crown claims are treated as unsecured. These provisions, establishing the Crown's status as an unsecured creditor, explicitly exempt statutory deemed trusts in source deductions (*CCAA*, s. 18.4(3); *BIA*, s. 86(3)). The *CCAA* provision reads as follows:

> **18.4** (3) Subsection (1) [Crown ranking as unsecured creditor] does not affect the operation of
>
> (a) subsections 224(1.2) and (1.3) of the *Income Tax Act*,
>
> (b) any provision of the *Canada Pension Plan* or of the *Employment Insurance Act* that refers to subsection 224(1.2) of the *Income Tax Act* and provides for the collection of a contribution ....

Therefore, not only does the *CCAA* provide that Crown claims do not enjoy priority over the claims of other creditors (s. 18.3(1)), but the exceptions to this rule (i.e., that Crown priority is maintained for source deductions) are repeatedly stated in the statute.

40 The apparent conflict in this case is whether the rule in the *CCAA* first enacted as s. 18.3 in 1997, which provides that subject to certain explicit exceptions, statutory deemed trusts are ineffective under the *CCAA*, is overridden by the one in the *ETA* enacted in 2000 stating that GST deemed trusts operate despite any enactment of Canada except the *BIA*. With respect for my colleague Fish J., I do not think the apparent conflict can be resolved by denying it and creating

a rule requiring both a statutory provision enacting the deemed trust, and a second statutory provision confirming it. Such a rule is unknown to the law. Courts must recognize conflicts, apparent or real, and resolve them when possible.

41 A line of jurisprudence across Canada has resolved the apparent conflict in favour of the *ETA*, thereby maintaining GST deemed trusts under the *CCAA*. *Ottawa Senators*, the leading case, decided the matter by invoking the doctrine of implied repeal to hold that the later in time provision of the *ETA* should take precedence over the *CCAA* (see also *Solid Resources Ltd., Re* (2002), 40 C.B.R. (4th) 219, [2003] G.S.T.C. 21 (Alta. Q.B.); *Gauntlet*

42 The Ontario Court of Appeal in *Ottawa Senators* rested its conclusion on two considerations. First, it was persuaded that by explicitly mentioning the *BIA* in *ETA* s. 222(3), but not the *CCAA*, Parliament made a deliberate choice. In the words of MacPherson J.A.:

> The *BIA* and the *CCAA* are closely related federal statutes. I cannot conceive that Parliament would specifically identify the *BIA* as an exception, but accidentally fail to consider the *CCAA* as a possible second exception. In my view, the omission of the *CCAA* from s. 222(3) of the *ETA* was almost certainly a considered omission. [para. 43]

43 Second, the Ontario Court of Appeal compared the conflict between the *ETA* and the *CCAA* to that before this Court in *Doré c. Verdun (Municipalité)*, [1997] 2 S.C.R. 862 (S.C.C.), and found them to be "identical" (para. 46). It therefore considered *Doré* binding (para. 49). In *Doré*, a limitations provision in the more general and recently enacted *Civil Code of Québec*, S.Q. 1991, c. 64 ("*C.C.Q.*"), was held to have repealed a more specific provision of the earlier Quebec *Cities and Towns Act*, R.S.Q., c. C-19, with which it conflicted. By analogy, the Ontario Court of Appeal held that the later in time and more general provision, s. 222(3) of the *ETA*, impliedly repealed the more specific and earlier in time provision, s. 18.3(1) of the *CCAA* (paras. 47-49).

44 Viewing this issue in its entire context, several considerations lead me to conclude that neither the reasoning nor the result in *Ottawa Senators* can stand. While a conflict may exist at the level of the statutes' wording, a purposive and contextual analysis to determine Parliament's true intent yields the conclusion that Parliament could not have intended to restore the Crown's deemed trust priority in GST claims under the *CCAA* when it amended the *ETA* in 2000 with the *Sparrow Electric* amendment.

45 I begin by recalling that Parliament has shown its willingness to move away from asserting priority for Crown claims in insolvency law. Section 18.3(1) of the *CCAA* (subject to the s. 18.3(2) exceptions) provides that the Crown's deemed trusts have no effect under the *CCAA*. Where Parliament has sought to protect certain Crown claims through statutory deemed trusts and intended that these deemed trusts continue in insolvency, it has legislated so explicitly and elaborately. For example, s. 18.3(2) of the *CCAA* and s. 67(3) of the *BIA* expressly provide that deemed trusts for source deductions remain effective in insolvency. Parliament has, therefore, clearly carved out exceptions from the general rule that deemed trusts are ineffective in insolvency. The *CCAA* and *BIA* are in harmony, preserving deemed trusts and asserting Crown priority only in respect of source deductions. Meanwhile, there is no express statutory basis for concluding that GST claims enjoy a preferred treatment under the *CCAA* or the *BIA*. Unlike source deductions, which are clearly and expressly dealt with under both these insolvency statutes, no such clear and express language exists in those Acts carving out an exception for GST claims.

46 The internal logic of the *CCAA* also militates against upholding the *ETA* deemed trust for GST. The *CCAA* imposes limits on a suspension by the court of the Crown's rights in respect of source deductions but does not mention the *ETA* (s. 11.4). Since source deductions deemed trusts are granted explicit protection under the *CCAA*, it would be inconsistent to afford a better protection to the *ETA* deemed trust absent explicit language in the *CCAA*. Thus, the logic of the *CCAA* appears to subject the *ETA* deemed trust to the waiver by Parliament of its priority (s. 18.4).

47 Moreover, a strange asymmetry would arise if the interpretation giving the *ETA* priority over the *CCAA* urged by the Crown is adopted here: the Crown would retain priority over GST claims during *CCAA* proceedings but not in bankruptcy. As courts have reflected, this can only encourage statute shopping by secured creditors in cases such as this

one where the debtor's assets cannot satisfy both the secured creditors' and the Crown's claims (*Gauntlet*, at para. 21). If creditors' claims were better protected by liquidation under the *BIA*, creditors' incentives would lie overwhelmingly with avoiding proceedings under the *CCAA* and not risking a failed reorganization. Giving a key player in any insolvency such skewed incentives against reorganizing under the *CCAA* can only undermine that statute's remedial objectives and risk inviting the very social ills that it was enacted to avert.

48 Arguably, the effect of *Ottawa Senators* is mitigated if restructuring is attempted under the *BIA* instead of the *CCAA*, but it is not cured. If *Ottawa Senators* were to be followed, Crown priority over GST would differ depending on whether restructuring took place under the *CCAA* or the *BIA*. The anomaly of this result is made manifest by the fact that it would deprive companies of the option to restructure under the more flexible and responsive *CCAA* regime, which has been the statute of choice for complex reorganizations.

49 Evidence that Parliament intended different treatments for GST claims in reorganization and bankruptcy is scant, if it exists at all. Section 222(3) of the *ETA* was enacted as part of a wide-ranging budget implementation bill in 2000. The summary accompanying that bill does not indicate that Parliament intended to elevate Crown priority over GST claims under the *CCAA* to the same or a higher level than source deductions claims. Indeed, the summary for deemed trusts states only that amendments to existing provisions are aimed at "ensuring that employment insurance premiums and Canada Pension Plan contributions that are required to be remitted by an employer are fully recoverable by the Crown in the case of the bankruptcy of the employer" (Summary to S.C. 2000, c. 30, at p. 4a). The wording of GST deemed trusts resembles that of statutory deemed trusts for source deductions and incorporates the same overriding language and reference to the *BIA*. However, as noted above, Parliament's express intent is that only source deductions deemed trusts remain operative. An exception for the *BIA* in the statutory language establishing the source deductions deemed trusts accomplishes very little, because the explicit language of the *BIA* itself (and the *CCAA*) carves out these source deductions deemed trusts and maintains their effect. It is however noteworthy that no equivalent language maintaining GST deemed trusts exists under either the *BIA* or the *CCAA*.

50 It seems more likely that by adopting the same language for creating GST deemed trusts in the *ETA* as it did for deemed trusts for source deductions, and by overlooking the inclusion of an exception for the *CCAA* alongside the *BIA* in s. 222(3) of the *ETA*, Parliament may have inadvertently succumbed to a drafting anomaly. Because of a statutory lacuna in the *ETA*, the GST deemed trust could be seen as remaining effective in the *CCAA*, while ceasing to have any effect under the *BIA*, thus creating an apparent conflict with the wording of the *CCAA*. However, it should be seen for what it is: a facial conflict only, capable of resolution by looking at the broader approach taken to Crown priorities and by giving precedence to the statutory language of s. 18.3 of the *CCAA* in a manner that does not produce an anomalous outcome.

51 Section 222(3) of the *ETA* evinces no explicit intention of Parliament to repeal *CCAA* s. 18.3. It merely creates an apparent conflict that must be resolved by statutory interpretation. Parliament's intent when it enacted *ETA* s. 222(3) was therefore far from unambiguous. Had it sought to give the Crown a priority for GST claims, it could have done so explicitly as it did for source deductions. Instead, one is left to infer from the language of *ETA* s. 222(3) that the GST deemed trust was intended to be effective under the *CCAA*.

52 I am not persuaded that the reasoning in *Doré* requires the application of the doctrine of implied repeal in the circumstances of this case. The main issue in *Doré* concerned the impact of the adoption of the *C.C.Q.* on the administrative law rules with respect to municipalities. While Gonthier J. concluded in that case that the limitation provision in art. 2930 *C.C.Q.* had repealed by implication a limitation provision in the *Cities and Towns Act*, he did so on the basis of more than a textual analysis. The conclusion in *Doré* was reached after thorough contextual analysis of both pieces of legislation, including an extensive review of the relevant legislative history (paras. 31-41). Consequently, the circumstances before this Court in *Doré* are far from "identical" to those in the present case, in terms of text, context and legislative history. Accordingly, *Doré* cannot be said to require the automatic application of the rule of repeal by implication.

53 A noteworthy indicator of Parliament's overall intent is the fact that in subsequent amendments it has not displaced the rule set out in the *CCAA*. Indeed, as indicated above, the recent amendments to the *CCAA* in 2005 resulted in the rule previously found in s. 18.3 being renumbered and reformulated as s. 37. Thus, to the extent the interpretation allowing the GST deemed trust to remain effective under the *CCAA* depends on *ETA* s. 222(3) having impliedly repealed *CCAA* s. 18.3(1) because it is later in time, we have come full circle. Parliament has renumbered and reformulated the provision of the *CCAA* stating that, subject to exceptions for source deductions, deemed trusts do not survive the *CCAA* proceedings and thus the *CCAA* is now the later in time statute. This confirms that Parliament's intent with respect to GST deemed trusts is to be found in the *CCAA*.

54 I do not agree with my colleague Abella J. that s. 44(*f*) of the *Interpretation Act*, R.S.C. 1985, c. I-21, can be used to interpret the 2005 amendments as having no effect. The new statute can hardly be said to be a mere re-enactment of the former statute. Indeed, the *CCAA* underwent a substantial review in 2005. Notably, acting consistently with its goal of treating both the *BIA* and the *CCAA* as sharing the same approach to insolvency, Parliament made parallel amendments to both statutes with respect to corporate proposals. In addition, new provisions were introduced regarding the treatment of contracts, collective agreements, interim financing and governance agreements. The appointment and role of the Monitor was also clarified. Noteworthy are the limits imposed by *CCAA* s. 11.09 on the court's discretion to make an order staying the Crown's source deductions deemed trusts, which were formerly found in s. 11.4. No mention whatsoever is made of GST deemed trusts (see Summary to S.C. 2005, c. 47). The review went as far as looking at the very expression used to describe the statutory override of deemed trusts. The comments cited by my colleague only emphasize the clear intent of Parliament to maintain its policy that only source deductions deemed trusts survive in *CCAA* proceedings.

55 In the case at bar, the legislative context informs the determination of Parliament's legislative intent and supports the conclusion that *ETA* s. 222(3) was not intended to narrow the scope of the *CCAA's* override provision. Viewed in its entire context, the conflict between the *ETA* and the *CCAA* is more apparent than real. I would therefore not follow the reasoning in *Ottawa Senators* and affirm that *CCAA* s. 18.3 remained effective.

56 My conclusion is reinforced by the purpose of the *CCAA* as part of Canadian remedial insolvency legislation. As this aspect is particularly relevant to the second issue, I will now discuss how courts have interpreted the scope of their discretionary powers in supervising a *CCAA* reorganization and how Parliament has largely endorsed this interpretation. Indeed, the interpretation courts have given to the *CCAA* helps in understanding how the *CCAA* grew to occupy such a prominent role in Canadian insolvency law.

3.3 Discretionary Power of a Court Supervising a CCAA Reorganization

57 Courts frequently observe that "[t]he *CCAA* is skeletal in nature" and does not "contain a comprehensive code that lays out all that is permitted or barred" (*ATB Financial v. Metcalfe & Mansfield Alternative Investments II Corp.*, 2008 ONCA 587, 92 O.R. (3d) 513 (Ont. C.A.), at para. 44, *per* Blair J.A.). Accordingly, "[t]he history of CCAA law has been an evolution of judicial interpretation" (*Dylex Ltd., Re* (1995), 31 C.B.R. (3d) 106 (Ont. Gen. Div. [Commercial List])), at para. 10, *per* Farley J.).

58 *CCAA* decisions are often based on discretionary grants of jurisdiction. The incremental exercise of judicial discretion in commercial courts under conditions one practitioner aptly describes as "the hothouse of real-time litigation" has been the primary method by which the *CCAA* has been adapted and has evolved to meet contemporary business and social needs (see Jones, at p. 484).

59 Judicial discretion must of course be exercised in furtherance of the *CCAA's* purposes. The remedial purpose I referred to in the historical overview of the Act is recognized over and over again in the jurisprudence. To cite one early example:

> 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.
>
> (*Nova Metal Products Inc. v. Comiskey (Trustee of)* (1990), 41 O.A.C. 282 (Ont. C.A.), at para. 57, *per* Doherty J.A., dissenting)

60 Judicial decision making under the *CCAA* takes many forms. A court must first of all provide the conditions under which the debtor can attempt to reorganize. This can be achieved by staying enforcement actions by creditors to allow the debtor's business to continue, preserving the *status quo* while the debtor plans the compromise or arrangement to be presented to creditors, and supervising the process and advancing it to the point where it can be determined whether it will succeed (see, e.g., *Hongkong Bank of Canada v. Chef Ready Foods Ltd.* (1990), 51 B.C.L.R. (2d) 84 (B.C. C.A.), at pp. 88-89; *Pacific National Lease Holding Corp., Re* (1992), 19 B.C.A.C. 134 (B.C. C.A. [In Chambers]), at para. 27). In doing so, the court must often be cognizant of the various interests at stake in the reorganization, which can extend beyond those of the debtor and creditors to include employees, directors, shareholders, and even other parties doing business with the insolvent company (see, e.g., *Canadian Airlines Corp., Re*, 2000 ABQB 442, 84 Alta. L.R. (3d) 9 (Alta. Q.B.), at para. 144, *per* Paperny J. (as she then was); *Air Canada, Re* (2003), 42 C.B.R. (4th) 173 (Ont. S.C.J. [Commercial List]), at para. 3; *Air Canada, Re* [2003 CarswellOnt 4967 (Ont. S.C.J. [Commercial List])], 2003 CanLII 49366, at para. 13, *per* Farley J.; Sarra, *Creditor Rights*, at pp. 181-92 and 217-26). In addition, courts must recognize that on occasion the broader public interest will be engaged by aspects of the reorganization and may be a factor against which the decision of whether to allow a particular action will be weighed (see, e.g., *Canadian Red Cross Society / Société Canadienne de la Croix Rouge, Re* (2000), 19 C.B.R. (4th) 158 (Ont. S.C.J.), at para. 2, *per* Blair J. (as he then was); Sarra, *Creditor Rights*, at pp. 195-214).

61 When large companies encounter difficulty, reorganizations become increasingly complex. *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*. Without exhaustively cataloguing the various measures taken under the authority of the *CCAA*, it is useful to refer briefly to a few examples to illustrate the flexibility the statute affords supervising courts.

62 Perhaps the most creative use of *CCAA* authority has been the increasing willingness of courts to authorize post-filing security for debtor in possession financing or super-priority charges on the debtor's assets when necessary for the continuation of the debtor's business during the reorganization (see, e.g., *Skydome Corp., Re* (1998), 16 C.B.R. (4th) 118 (Ont. Gen. Div. [Commercial List]); *United Used Auto & Truck Parts Ltd., Re*, 2000 BCCA 146, 135 B.C.A.C. 96 (B.C. C.A.), aff'g (1999), 12 C.B.R. (4th) 144 (B.C. S.C. [In Chambers]); and generally, J. P. Sarra, *Rescue! The Companies' Creditors Arrangement Act* (2007), at pp. 93-115). The *CCAA* has also been used to release claims against third parties as part of approving a comprehensive plan of arrangement and compromise, even over the objections of some dissenting creditors (see Metcalfe & Mansfield). As well, the appointment of a Monitor to oversee the reorganization was originally a measure taken pursuant to the *CCAA's* supervisory authority; Parliament responded, making the mechanism mandatory by legislative amendment.

63 Judicial innovation during *CCAA* proceedings has not been without controversy. At least two questions it raises are directly relevant to the case at bar: (1) what are the sources of a court's authority during *CCAA* proceedings? (2) what are the limits of this authority?

64 The first question concerns the boundary between a court's statutory authority under the *CCAA* and a court's residual authority under its inherent and equitable jurisdiction when supervising a reorganization. In authorizing measures during *CCAA* proceedings, courts have on occasion purported to rely upon their equitable jurisdiction to advance the purposes of the Act or their inherent jurisdiction to fill gaps in the statute. Recent appellate decisions have counselled against purporting to rely on inherent jurisdiction, holding that the better view is that courts are in most cases

simply construing the authority supplied by the *CCAA* itself (see, e.g., *Skeena Cellulose Inc., Re*, 2003 BCCA 344, 13 B.C.L.R. (4th) 236 (B.C. C.A.), at paras. 45-47, *per* Newbury J.A.; *Stelco Inc. (Re)* (2005), 75 O.R. (3d) 5 (Ont. C.A.), paras. 31-33, *per* Blair J.A.).

65 I agree with Justice Georgina R. Jackson and Professor Janis Sarra that the most appropriate approach is a hierarchical one in which courts rely first on an interpretation of the provisions of the *CCAA* text before turning to inherent or equitable jurisdiction to anchor measures taken in a *CCAA* proceeding (see 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 p. 42). The authors conclude that when given an appropriately purposive and liberal interpretation, the *CCAA* will be sufficient in most instances to ground measures necessary to achieve its objectives (p. 94).

66 Having examined the pertinent parts of the *CCAA* and the recent history of the legislation, I accept that in most instances the issuance of an order during *CCAA* proceedings should be considered an exercise in statutory interpretation. Particularly noteworthy in this regard is the expansive interpretation the language of the statute at issue is capable of supporting.

67 The initial grant of authority under the *CCAA* empowered a court "where an application is made under this Act in respect of a company ... on the application of any person interested in the matter ..., subject to this Act, [to] make an order under this section" (*CCAA*, s. 11(1)). The plain language of the statute was very broad.

68 In this regard, though not strictly applicable to the case at bar, I note that Parliament has in recent amendments changed the wording contained in s. 11(1), making explicit the discretionary authority of the court under the *CCAA*. Thus in s. 11 of the *CCAA* as currently enacted, a court may, "subject to the restrictions set out in this Act, ... make any order that it considers appropriate in the circumstances" (S.C. 2005, c. 47, s. 128). Parliament appears to have endorsed the broad reading of *CCAA* authority developed by the jurisprudence.

69 The *CCAA* also explicitly provides for certain orders. Both an order made on an initial application and an order on subsequent applications may stay, restrain, or prohibit existing or new proceedings against the debtor. The burden is on the applicant to satisfy the court that the order is appropriate in the circumstances and that the applicant has been acting in good faith and with due diligence (*CCAA*, ss. 11(3), (4) and (6)).

70 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. 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. 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.

71 It is well-established that efforts to reorganize under the *CCAA* can be terminated and the stay of proceedings against the debtor lifted if the reorganization is "doomed to failure" (see *Chef Ready*, at p. 88; *Philip's Manufacturing Ltd., Re* (1992), 9 C.B.R. (3d) 25 (B.C. C.A.), at paras. 6-7). However, when an order is sought that does realistically advance the *CCAA's* purposes, the ability to make it is within the discretion of a *CCAA* court.

72 The preceding discussion assists in determining whether the court had authority under the *CCAA* to continue the stay of proceedings against the Crown once it was apparent that reorganization would fail and bankruptcy was the inevitable next step.

73 In the Court of Appeal, Tysoe J.A. held that no authority existed under the *CCAA* to continue staying the Crown's enforcement of the GST deemed trust once efforts at reorganization had come to an end. The appellant submits that in so holding, Tysoe J.A. failed to consider the underlying purpose of the *CCAA* and give the statute an appropriately purposive and liberal interpretation under which the order was permissible. The Crown submits that Tysoe J.A. correctly held that the mandatory language of the *ETA* gave the court no option but to permit enforcement of the GST deemed trust when lifting the *CCAA* stay to permit the debtor to make an assignment under the *BIA*. Whether the *ETA* has a mandatory effect in the context of a *CCAA* proceeding has already been discussed. I will now address the question of whether the order was authorized by the *CCAA*.

74 It is beyond dispute that the *CCAA* imposes no explicit temporal limitations upon proceedings commenced under the Act that would prohibit ordering a continuation of the stay of the Crown's GST claims while lifting the general stay of proceedings temporarily to allow the debtor to make an assignment in bankruptcy.

75 The question remains whether the order advanced the underlying purpose of the *CCAA*. The Court of Appeal held that it did not because the reorganization efforts had come to an end and the *CCAA* was accordingly spent. I disagree.

76 There is no doubt that had reorganization been commenced under the *BIA* instead of the *CCAA*, the Crown's deemed trust priority for the GST funds would have been lost. Similarly, the Crown does not dispute that under the scheme of distribution in bankruptcy under the *BIA*, the deemed trust for GST ceases to have effect. Thus, after reorganization under the *CCAA* failed, creditors would have had a strong incentive to seek immediate bankruptcy and distribution of the debtor's assets under the *BIA*. In order to conclude that the discretion does not extend to partially lifting the stay in order to allow for an assignment in bankruptcy, one would have to assume a gap between the *CCAA* and the *BIA* proceedings. Brenner C.J.S.C.'s order staying Crown enforcement of the GST claim ensured that creditors would not be disadvantaged by the attempted reorganization under the *CCAA*. The effect of his order was to blunt any impulse of creditors to interfere in an orderly liquidation. His order was thus in furtherance of the *CCAA's* objectives to the extent that it allowed a bridge between the *CCAA* and *BIA* proceedings. This interpretation of the tribunal's discretionary power is buttressed by s. 20 of the *CCAA*. That section provides that the *CCAA* "may be applied together with the provisions of any Act of Parliament... that authorizes or makes provision for the sanction of compromises or arrangements between a company and its shareholders or any class of them", such as the *BIA*. Section 20 clearly indicates the intention of Parliament for the *CCAA* to operate *in tandem* with other insolvency legislation, such as the *BIA*.

77 The *CCAA* creates conditions for preserving the *status quo* while attempts are made to find common ground amongst stakeholders for a reorganization that is fair to all. Because the alternative to reorganization is often bankruptcy, participants will measure the impact of a reorganization against the position they would enjoy in liquidation. In the case at bar, the order fostered a harmonious transition between reorganization and liquidation while meeting the objective of a single collective proceeding that is common to both statutes.

78 Tysoe J.A. therefore erred in my view by treating the *CCAA* and the *BIA* as distinct regimes subject to a temporal gap between the two, rather than as forming part of an integrated body of insolvency law. Parliament's decision to maintain two statutory schemes for reorganization, the *BIA* and the *CCAA*, reflects the reality that reorganizations of differing complexity require different legal mechanisms. By contrast, only one statutory scheme has been found to be needed to liquidate a bankrupt debtor's estate. The transition from the *CCAA* to the *BIA* may require the partial lifting of a stay of proceedings under the *CCAA* to allow commencement of the *BIA* proceedings. However, as Laskin J.A. for the Ontario Court of Appeal noted in a similar competition between secured creditors and the Ontario Superintendent of Financial Services seeking to enforce a deemed trust, "[t]he two statutes are related" and no "gap" exists between the two statutes which would allow the enforcement of property interests at the conclusion of *CCAA* proceedings that would be lost in bankruptcy *Ivaco Inc. (Re)* (2006), 83 O.R. (3d) 108 (Ont. C.A.), at paras. 62-63).

79 The Crown's priority in claims pursuant to source deductions deemed trusts does not undermine this conclusion. Source deductions deemed trusts survive under both the *CCAA* and the *BIA*. Accordingly, creditors' incentives to prefer

one Act over another will not be affected. While a court has a broad discretion to stay source deductions deemed trusts in the *CCAA* context, this discretion is nevertheless subject to specific limitations applicable only to source deductions deemed trusts (*CCAA*, s. 11.4). Thus, if *CCAA* reorganization fails (e.g., either the creditors or the court refuse a proposed reorganization), the Crown can immediately assert its claim in unremitted source deductions. But this should not be understood to affect a seamless transition into bankruptcy or create any "gap" between the *CCAA* and the *BIA* for the simple reason that, regardless of what statute the reorganization had been commenced under, creditors' claims in both instances would have been subject to the priority of the Crown's source deductions deemed trust.

80 Source deductions deemed trusts aside, the comprehensive and exhaustive mechanism under the *BIA* must control the distribution of the debtor's assets once liquidation is inevitable. Indeed, an orderly transition to liquidation is mandatory under the *BIA* where a proposal is rejected by creditors. The *CCAA* is silent on the transition into liquidation but the breadth of the court's discretion under the Act is sufficient to construct a bridge to liquidation under the *BIA*. The court must do so in a manner that does not subvert the scheme of distribution under the *BIA*. Transition to liquidation requires partially lifting the *CCAA* stay to commence proceedings under the *BIA*. This necessary partial lifting of the stay should not trigger a race to the courthouse in an effort to obtain priority unavailable under the *BIA*.

81 I therefore conclude that Brenner C.J.S.C. had the authority under the *CCAA* to lift the stay to allow entry into liquidation.

3.4 Express Trust

82 The last issue in this case is whether Brenner C.J.S.C. created an express trust in favour of the Crown when he ordered on April 29, 2008, that proceeds from the sale of LeRoy Trucking's assets equal to the amount of unremitted GST be held back in the Monitor's trust account until the results of the reorganization were known. Tysoe J.A. in the Court of Appeal concluded as an alternative ground for allowing the Crown's appeal that it was the beneficiary of an express trust. I disagree.

83 Creation of an express trust requires the presence of three certainties: intention, subject matter, and object. Express or "true trusts" arise from the acts and intentions of the settlor and are distinguishable from other trusts arising by operation of law (see D. W. M. Waters, M. R. Gillen and L. D. Smith, eds., *Waters' Law of Trusts in Canada* (3rd ed. 2005), at pp. 28-29 especially fn. 42).

84 Here, there is no certainty to the object (i.e. the beneficiary) inferrable from the court's order of April 29, 2008, sufficient to support an express trust.

85 At the time of the order, there was a dispute between Century Services and the Crown over part of the proceeds from the sale of the debtor's assets. The court's solution was to accept LeRoy Trucking's proposal to segregate those monies until that dispute could be resolved. Thus there was no certainty that the Crown would actually be the beneficiary, or object, of the trust.

86 The fact that the location chosen to segregate those monies was the Monitor's trust account has no independent effect such that it would overcome the lack of a clear beneficiary. In any event, under the interpretation of *CCAA* s. 18.3(1) established above, no such priority dispute would even arise because the Crown's deemed trust priority over GST claims would be lost under the *CCAA* and the Crown would rank as an unsecured creditor for this amount. However, Brenner C.J.S.C. may well have been proceeding on the basis that, in accordance with *Ottawa Senators*, the Crown's GST claim would remain effective if reorganization was successful, which would not be the case if transition to the liquidation process of the *BIA* was allowed. An amount equivalent to that claim would accordingly be set aside pending the outcome of reorganization.

87 Thus, uncertainty surrounding the outcome of the *CCAA* restructuring eliminates the existence of any certainty to permanently vest in the Crown a beneficial interest in the funds. That much is clear from the oral reasons of Brenner C.J.S.C. on April 29, 2008, when he said: "Given the fact that [*CCAA* proceedings] are known to fail and filings in

bankruptcy result, it seems to me that maintaining the status quo in the case at bar supports the proposal to have the monitor hold these funds in trust." Exactly who might take the money in the final result was therefore evidently in doubt. Brenner C.J.S.C.'s subsequent order of September 3, 2008, denying the Crown's application to enforce the trust once it was clear that bankruptcy was inevitable, confirms the absence of a clear beneficiary required to ground an express trust.

4. Conclusion

88 I conclude that Brenner C.J.S.C. had the discretion under the *CCAA* to continue the stay of the Crown's claim for enforcement of the GST deemed trust while otherwise lifting it to permit LeRoy Trucking to make an assignment in bankruptcy. My conclusion that s. 18.3(1) of the *CCAA* nullified the GST deemed trust while proceedings under that Act were pending confirms that the discretionary jurisdiction under s. 11 utilized by the court was not limited by the Crown's asserted GST priority, because there is no such priority under the *CCAA*.

89 For these reasons, I would allow the appeal and declare that the $305,202.30 collected by LeRoy Trucking in respect of GST but not yet remitted to the Receiver General of Canada is not subject to deemed trust or priority in favour of the Crown. Nor is this amount subject to an express trust. Costs are awarded for this appeal and the appeal in the court below.

***Fish J. (concurring)*:**

I

90 I am in general agreement with the reasons of Justice Deschamps and would dispose of the appeal as she suggests.

91 More particularly, I share my colleague's interpretation of the scope of the judge's discretion under s. 11 of the *Companies' Creditors Arrangement Act*, R.S.C. 1985, c. C-36 ("*CCAA*"). And I share my colleague's conclusion that Brenner C.J.S.C. did not create an express trust in favour of the Crown when he segregated GST funds into the Monitor's trust account (2008 BCSC 1805, [2008] G.S.T.C. 221 (B.C. S.C. [In Chambers])).

92 I nonetheless feel bound to add brief reasons of my own regarding the interaction between the *CCAA* and the *Excise Tax Act*, R.S.C. 1985, c. E-15 ("*ETA*").

93 In upholding deemed trusts created by the *ETA* notwithstanding insolvency proceedings, *Ottawa Senators Hockey Club Corp. (Re)* (2005), 73 O.R. (3d) 737, [2005] G.S.T.C. 1 (Ont. C.A.), and its progeny have been unduly protective of Crown interests which Parliament itself has chosen to subordinate to competing prioritized claims. In my respectful view, a clearly marked departure from that jurisprudential approach is warranted in this case.

94 Justice Deschamps develops important historical and policy reasons in support of this position and I have nothing to add in that regard. I do wish, however, to explain why a comparative analysis of related statutory provisions adds support to our shared conclusion.

95 Parliament has in recent years given detailed consideration to the Canadian insolvency scheme. It has declined to amend the provisions at issue in this case. Ours is not to wonder why, but rather to treat Parliament's preservation of the relevant provisions as a deliberate exercise of the legislative discretion that is Parliament's alone. With respect, I reject any suggestion that we should instead characterize the apparent conflict between s. 18.3(1) (now s. 37(1)) of the *CCAA* and s. 222 of the *ETA* as a drafting anomaly or statutory lacuna properly subject to judicial correction or repair.

II

96 In the context of the Canadian insolvency regime, a deemed trust will be found to exist only where two complementary elements co-exist: first, a statutory provision *creating* the trust; and second, a *CCAA* or *Bankruptcy and Insolvency Act*, R.S.C. 1985, c. B-3 ("*BIA*") provision *confirming* — or explicitly preserving — its effective operation.

97 This interpretation is reflected in three federal statutes. Each contains a deemed trust provision framed in terms strikingly similar to the wording of s. 222 of the *ETA*.

98 The first is the *Income Tax Act*, R.S.C. 1985, c. 1 (5th Supp.) ("*ITA*") where s. 227(4) *creates* a deemed trust:

> **227 (4) Trust for moneys deducted** — Every person who deducts or withholds an amount under this Act is deemed, notwithstanding any security interest (as defined in subsection 224(1.3)) in the amount so deducted or withheld, to hold the amount separate and apart from the property of the person and from property held by any secured creditor (as defined in subsection 224(1.3)) of that person that but for the security interest would be property of the person, in trust for Her Majesty and for payment to Her Majesty in the manner and at the time provided under this Act. [Here and below, the emphasis is of course my own.]

99 In the next subsection, Parliament has taken care to make clear that this trust is unaffected by federal or provincial legislation to the contrary:

> **(4.1) Extension of trust** — Notwithstanding any other provision of this Act, the *Bankruptcy and Insolvency Act* (except sections 81.1 and 81.2 of that Act), any other enactment of Canada, any enactment of a province or any other law, where at any time an amount deemed by subsection 227(4) to be held by a person in trust for Her Majesty is not paid to Her Majesty in the manner and at the time provided under this Act, property of the person ... equal in value to the amount so deemed to be held in trust is deemed
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> > (a) to be held, from the time the amount was deducted or withheld by the person, separate and apart from the property of the person, in trust for Her Majesty whether or not the property is subject to such a security interest, ...
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> > ...
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> ... and the proceeds of such property shall be paid to the Receiver General in priority to all such security interests.

100 The continued operation of this deemed trust is expressly *confirmed* in s. 18.3 of the *CCAA*:

> **18.3** (1) Subject to subsection (2), notwithstanding any provision in federal or provincial legislation that has the effect of deeming property to be held in trust for Her Majesty, property of a debtor company shall not be regarded as being held in trust for Her Majesty unless it would be so regarded in the absence of that statutory provision.
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> (2) Subsection (1) does not apply in respect of amounts deemed to be held in trust under subsection 227(4) or (4.1) of the *Income Tax Act*, subsection 23(3) or (4) of the *Canada Pension Plan* or subsection 86(2) or (2.1) of the *Employment Insurance Act*....

101 The operation of the *ITA* deemed trust is also confirmed in s. 67 of the *BIA*:

> **67** (2) Subject to subsection (3), notwithstanding any provision in federal or provincial legislation that has the effect of deeming property to be held in trust for Her Majesty, property of a bankrupt shall not be regarded as held in trust for Her Majesty for the purpose of paragraph (1)(*a*) unless it would be so regarded in the absence of that statutory provision.
>
> (3) Subsection (2) does not apply in respect of amounts deemed to be held in trust under subsection 227(4) or (4.1) of the *Income Tax Act*, subsection 23(3) or (4) of the *Canada Pension Plan* or subsection 86(2) or (2.1) of the *Employment Insurance Act*....

102 Thus, Parliament has first *created* and then *confirmed the continued operation of* the Crown's *ITA* deemed trust under *both* the *CCAA* and the *BIA* regimes.

103 The second federal statute for which this scheme holds true is the *Canada Pension Plan*, R.S.C. 1985, c. C-8 ("*CPP*"). At s. 23, Parliament creates a deemed trust in favour of the Crown and specifies that it exists despite all contrary provisions in any other Canadian statute. Finally, and in almost identical terms, the *Employment Insurance Act*, S.C. 1996, c. 23 ("*EIA*"), creates a deemed trust in favour of the Crown: see ss. 86(2) and (2.1).

104 As we have seen, the survival of the deemed trusts created under these provisions of the *ITA*, the *CPP* and the *EIA* is confirmed in s. 18.3(2) the *CCAA* and in s. 67(3) the *BIA*. In all three cases, Parliament's intent to enforce the Crown's deemed trust through insolvency proceedings is expressed in clear and unmistakable terms.

105 The same is not true with regard to the deemed trust created under the *ETA*. Although Parliament creates a deemed trust in favour of the Crown to hold unremitted GST monies, and although it purports to maintain this trust notwithstanding any contrary federal or provincial legislation, it does not *confirm* the trust — or expressly provide for its continued operation — in either the *BIA* or the *CCAA*. The second of the two mandatory elements I have mentioned is thus absent reflecting Parliament's intention to allow the deemed trust to lapse with the commencement of insolvency proceedings.

106 The language of the relevant *ETA* provisions is identical in substance to that of the *ITA*, *CPP*, and *EIA* provisions:

> **222. (1) [Deemed] Trust for amounts collected** — Subject to subsection (1.1), every person who collects an amount as or on account of tax under Division II is deemed, for all purposes and despite any security interest in the amount, to hold the amount in trust for Her Majesty in right of Canada, separate and apart from the property of the person and from property held by any secured creditor of the person that, but for a security interest, would be property of the person, until the amount is remitted to the Receiver General or withdrawn under subsection (2).
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> ...
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> **(3) Extension of trust** — Despite any other provision of this Act (except subsection (4)), any other enactment of Canada (except the *Bankruptcy and Insolvency Act*), any enactment of a province or any other law, if at any time an amount deemed by subsection (1) to be held by a person in trust for Her Majesty is not remitted to the Receiver General or withdrawn in the manner and at the time provided under this Part, property of the person and property held by any secured creditor of the person that, but for a security interest, would be property of the person, equal in value to the amount so deemed to be held in trust, is deemed
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> > (a) to be held, from the time the amount was collected by the person, in trust for Her Majesty, separate and apart from the property of the person, whether or not the property is subject to a security interest, ...
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> > ...
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> ... and the proceeds of the property shall be paid to the Receiver General in priority to all security interests.

107 Yet no provision of the *CCAA* provides for the continuation of this deemed trust after the *CCAA* is brought into play.

108 In short, Parliament has imposed *two* explicit conditions, or "building blocks", for survival under the *CCAA* of deemed trusts created by the *ITA*, *CPP*, and *EIA*. Had Parliament intended to likewise preserve under the *CCAA* deemed trusts created by the *ETA*, it would have included in the *CCAA* the sort of confirmatory provision that explicitly preserves other deemed trusts.

109 With respect, unlike Tysoe J.A., I do not find it "inconceivable that Parliament would specifically identify the *BIA* as an exception when enacting the current version of s. 222(3) of the *ETA* without considering the *CCAA* as a possible second exception" (2009 BCCA 205, 98 B.C.L.R. (4th) 242, [2009] G.S.T.C. 79 (B.C. C.A.), at para. 37). *All* of the deemed trust provisions excerpted above make explicit reference to the *BIA*. Section 222 of the *ETA* does not break

the pattern. Given the near-identical wording of the four deemed trust provisions, it would have been surprising indeed had Parliament not addressed the *BIA* at all in the *ETA*.

110 Parliament's evident intent was to render GST deemed trusts inoperative upon the institution of insolvency proceedings. Accordingly, s. 222 mentions the *BIA* so as to *exclude* it from its ambit — rather than to *include* it, as do the *ITA*, the *CPP*, and the *EIA*.

111 Conversely, I note that *none* of these statutes mentions the *CCAA* expressly. Their specific reference to the *BIA* has no bearing on their interaction with the *CCAA*. Again, it is the confirmatory provisions *in the insolvency statutes* that determine whether a given deemed trust will subsist during insolvency proceedings.

112 Finally, I believe that chambers judges should not segregate GST monies into the Monitor's trust account during *CCAA* proceedings, as was done in this case. The result of Justice Deschamps's reasoning is that GST claims become unsecured under the *CCAA*. Parliament has deliberately chosen to nullify certain Crown super-priorities during insolvency; this is one such instance.

III

113 For these reasons, like Justice Deschamps, I would allow the appeal with costs in this Court and in the courts below and order that the $305,202.30 collected by LeRoy Trucking in respect of GST but not yet remitted to the Receiver General of Canada be subject to no deemed trust or priority in favour of the Crown.

***Abella J. (dissenting)*:**

114 The central issue in this appeal is whether s. 222 of the *Excise Tax Act*, R.S.C. 1985, c. E-15 ("*EIA*"), and specifically s. 222(3), gives priority during *Companies' Creditors Arrangement Act*, R.S.C. 1985, c. C-36 ("*CCAA*"), proceedings to the Crown's deemed trust in unremitted GST. I agree with Tysoe J.A. that it does. It follows, in my respectful view, that a court's discretion under s. 11 of the *CCAA* is circumscribed accordingly.

115 Section 11 [1] of the *CCAA* stated:

> **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.

To decide the scope of the court's discretion under s. 11, it is necessary to first determine the priority issue. Section 222(3), the provision of the *ETA* at issue in this case, states:

> **222 (3) Extension of trust** — Despite any other provision of this Act (except subsection (4)), any other enactment of Canada (except the *Bankruptcy and Insolvency Act*), any enactment of a province or any other law, if at any time an amount deemed by subsection (1) to be held by a person in trust for Her Majesty is not remitted to the Receiver General or withdrawn in the manner and at the time provided under this Part, property of the person and property held by any secured creditor of the person that, but for a security interest, would be property of the person, equal in value to the amount so deemed to be held in trust, is deemed
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> (a) to be held, from the time the amount was collected by the person, in trust for Her Majesty, separate and apart from the property of the person, whether or not the property is subject to a security interest, and
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> (b) to form no part of the estate or property of the person from the time the amount was collected, whether or not the property has in fact been kept separate and apart from the estate or property of the person and whether or not the property is subject to a security interest

and is property beneficially owned by Her Majesty in right of Canada despite any security interest in the property or in the proceeds thereof and the proceeds of the property shall be paid to the Receiver General in priority to all security interests.

116 Century Services argued that the *CCAA's* general override provision, s. 18.3(1), prevailed, and that the deeming provisions in s. 222 of the *ETA* were, accordingly, inapplicable during *CCAA* proceedings. Section 18.3(1) states:

> **18.3** (1) ... [N]otwithstanding any provision in federal or provincial legislation that has the effect of deeming property to be held in trust for Her Majesty, property of a debtor company shall not be regarded as held in trust for Her Majesty unless it would be so regarded in the absence of that statutory provision.

117 As MacPherson J.A. correctly observed in *Ottawa Senators Hockey Club Corp. (Re)* (2005), 73 O.R. (3d) 737, [2005] G.S.T.C. 1 (Ont. C.A.), s. 222(3) of the *ETA* is in "clear conflict" with s. 18.3(1) of the *CCAA* (para. 31). Resolving the conflict between the two provisions is, essentially, what seems to me to be a relatively uncomplicated exercise in statutory interpretation: does the language reflect a clear legislative intention? In my view it does. The deemed trust provision, s. 222(3) of the *ETA*, has unambiguous language stating that it operates notwithstanding any law except the *Bankruptcy and Insolvency Act*, R.S.C. 1985, c. B-3 ("*BIA*").

118 By expressly excluding only one statute from its legislative grasp, and by unequivocally stating that it applies despite any other law anywhere in Canada *except* the *BIA*, s. 222(3) has defined its boundaries in the clearest possible terms. I am in complete agreement with the following comments of MacPherson J.A. in *Ottawa Senators*:

> The legislative intent of s. 222(3) of the *ETA* is clear. If there is a conflict with "any other enactment of Canada (except the *Bankruptcy and Insolvency Act*)", s. 222(3) prevails. In these words Parliament did two things: it decided that s. 222(3) should trump all other federal laws and, importantly, it addressed the topic of exceptions to its trumping decision and identified a single exception, the *Bankruptcy and Insolvency Act* .... The *BIA* and the *CCAA* are closely related federal statutes. I cannot conceive that Parliament would specifically identify the *BIA* as an exception, but accidentally fail to consider the *CCAA* as a possible second exception. In my view, the omission of the *CCAA* from s. 222(3) of the *ETA* was almost certainly a considered omission. [para. 43]

119 MacPherson J.A.'s view that the failure to exempt the *CCAA* from the operation of the *ETA* is a reflection of a clear legislative intention, is borne out by how the *CCAA* was subsequently changed after s. 18.3(1) was enacted in 1997. In 2000, when s. 222(3) of the *ETA* came into force, amendments were also introduced to the *CCAA*. Section 18.3(1) was not amended.

120 The failure to amend s. 18.3(1) is notable because its effect was to protect the legislative *status quo*, notwithstanding repeated requests from various constituencies that s. 18.3(1) be amended to make the priorities in the *CCAA* consistent with those in the *BIA*. In 2002, for example, when Industry Canada conducted a review of the *BIA* and the *CCAA*, the Insolvency Institute of Canada and the Canadian Association of Insolvency and Restructuring Professionals recommended that the priority regime under the *BIA* be extended to the *CCAA* (Joint Task Force on Business Insolvency Law Reform, *Report* (March 15, 2002), Sch. B, proposal 71, at pp. 37-38). The same recommendations were made by the Standing Senate Committee on Banking, Trade and Commerce in its 2003 report, *Debtors and Creditors Sharing the Burden: A Review of the Bankruptcy and Insolvency Act and the Companies' Creditors Arrangement Act*; by the Legislative Review Task Force (Commercial) of the Insolvency Institute of Canada and the Canadian Association of Insolvency and Restructuring Professionals in its 2005 *Report on the Commercial Provisions of Bill C-55*; and in 2007 by the Insolvency Institute of Canada in a submission to the Standing Senate Committee on Banking, Trade and Commerce commenting on reforms then under consideration.

121 Yet the *BIA* remains the only exempted statute under s. 222(3) of the *ETA*. Even after the 2005 decision in *Ottawa Senators* which confirmed that the *ETA* took precedence over the *CCAA*, there was no responsive legislative revision.

I see this lack of response as relevant in this case, as it was in *R. v. Tele-Mobile Co.*, 2008 SCC 12, [2008] 1 S.C.R. 305 (S.C.C.), where this Court stated:

> While it cannot be said that legislative silence is necessarily determinative of legislative intention, in this case the silence is Parliament's answer to the consistent urging of Telus and other affected businesses and organizations that there be express language in the legislation to ensure that businesses can be reimbursed for the reasonable costs of complying with evidence-gathering orders. I see the legislative history as reflecting Parliament's intention that compensation not be paid for compliance with production orders. [para. 42]

122 All this leads to a clear inference of a deliberate legislative choice to protect the deemed trust in s. 222(3) from the reach of s. 18.3(1) of the *CCAA*.

123 Nor do I see any "policy" justification for interfering, through interpretation, with this clarity of legislative intention. I can do no better by way of explaining why I think the policy argument cannot succeed in this case, than to repeat the words of Tysoe J.A. who said:

> I do not dispute that there are valid policy reasons for encouraging insolvent companies to attempt to restructure their affairs so that their business can continue with as little disruption to employees and other stakeholders as possible. It is appropriate for the courts to take such policy considerations into account, but only if it is in connection with a matter that has not been considered by Parliament. Here, Parliament must be taken to have weighed policy considerations when it enacted the amendments to the *CCAA* and *ETA* described above. As Mr. Justice MacPherson observed at para. 43 of *Ottawa Senators*, it is inconceivable that Parliament would specifically identify the *BIA* as an exception when enacting the current version of s. 222(3) of the *ETA* without considering the *CCAA* as a possible second exception. I also make the observation that the 1992 set of amendments to the *BIA* enabled proposals to be binding on secured creditors and, while there is more flexibility under the *CCAA*, it is possible for an insolvent company to attempt to restructure under the auspices of the *BIA*. [para. 37]

124 Despite my view that the clarity of the language in s. 222(3) is dispositive, it is also my view that even the application of other principles of interpretation reinforces this conclusion. In their submissions, the parties raised the following as being particularly relevant: the Crown relied on the principle that the statute which is "later in time" prevails; and Century Services based its argument on the principle that the general provision gives way to the specific (*generalia specialibus non derogani*).

125 The "later in time" principle gives priority to a more recent statute, based on the theory that the legislature is presumed to be aware of the content of existing legislation. If a new enactment is inconsistent with a prior one, therefore, the legislature is presumed to have intended to derogate from the earlier provisions (Ruth Sullivan, *Sullivan on the Construction of Statutes* (5th ed. 2008), at pp. 346-47; Pierre-André Côté, *The Interpretation of Legislation in Canada* (3rd ed. 2000), at p. 358).

126 The exception to this presumptive displacement of pre-existing inconsistent legislation, is the *generalia specialibus non derogant* principle that "[a] more recent, general provision will not be construed as affecting an earlier, special provision" (Côté, at p. 359). Like a Russian Doll, there is also an exception within this exception, namely, that an earlier, specific provision may in fact be "overruled" by a subsequent general statute if the legislature indicates, through its language, an intention that the general provision prevails (*Doré c. Verdun (Municipalité)*, [1997] 2 S.C.R. 862 (S.C.C.)).

127 The primary purpose of these interpretive principles is to assist in the performance of the task of determining the intention of the legislature. This was confirmed by MacPherson J.A. in *Ottawa Senators*, at para. 42:

> [T]he overarching rule of statutory interpretation is that statutory provisions should be interpreted to give effect to the intention of the legislature in enacting the law. This primary rule takes precedence over all maxims or canons or aids relating to statutory interpretation, including the maxim that the specific prevails over the general (*generalia specialibus non derogant*). As expressed by Hudson J. in *Canada v. Williams*, [1944] S.C.R. 226, ... at p. 239 ...:

> The maxim *generalia specialibus non derogant* is relied on as a rule which should dispose of the question, but the maxim is not a rule of law but a rule of construction and bows to the intention of the legislature, if such intention can reasonably be gathered from all of the relevant legislation.

(See also Côté, at p. 358, and Pierre-Andre Côté, with the collaboration of S. Beaulac and M. Devinat, *Interprétation des lois* (4th ed. 2009), at para. 1335.)

128 I accept the Crown's argument that the "later in time" principle is conclusive in this case. Since s. 222(3) of the *ETA* was enacted in 2000 and s. 18.3(1) of the *CCAA* was introduced in 1997, s. 222(3) is, on its face, the later provision. This chronological victory can be displaced, as Century Services argues, if it is shown that the more recent provision, s. 222(3) of the *ETA*, is a general one, in which case the earlier, specific provision, s. 18.3(1), prevails (*generalia specialibus non derogant*). But, as previously explained, the prior specific provision does not take precedence if the subsequent general provision appears to "overrule" it. This, it seems to me, is precisely what s. 222(3) achieves through the use of language stating that it prevails despite any law of Canada, of a province, or "any other law" *other than the BIA*. Section 18.3(1) of the *CCAA*, is thereby rendered inoperative for purposes of s. 222(3).

129 It is true that when the *CCAA* was amended in 2005, [2] s. 18.3(1) was re-enacted as s. 37(1) (S.C. 2005, c. 47, s. 131). Deschamps J. suggests that this makes s. 37(1) the new, "later in time" provision. With respect, her observation is refuted by the operation of s. 44(f) of the *Interpretation Act*, R.S.C. 1985, c. I-21, which expressly deals with the (non) effect of re-enacting, without significant substantive changes, a repealed provision (see *Canada (Attorney General) v. Canada (Public Service Staff Relations Board)*, [1977] 2 F.C. 663 (Fed. C.A.), dealing with the predecessor provision to s. 44(f)). It directs that new enactments not be construed as "new law" unless they differ in substance from the repealed provision:

> **44.** Where an enactment, in this section called the "former enactment", is repealed and another enactment, in this section called the "new enactment", is substituted therefor,
>
> ...
>
> (f) except to the extent that the provisions of the new enactment are not in substance the same as those of the former enactment, the new enactment shall not be held to operate as new law, but shall be construed and have effect as a consolidation and as declaratory of the law as contained in the former enactment;

Section 2 of the *Interpretation Act* defines an enactment as "an Act or regulation or *any portion of an Act or regulation*".

130 Section 37(1) of the current *CCAA* is almost identical to s. 18.3(1). These provisions are set out for ease of comparison, with the differences between them underlined:

> **37.**(1) Subject to subsection (2), despite any provision in federal or provincial legislation that has the effect of deeming property to be held in trust for Her Majesty, property of a debtor company shall not be regarded as being held in trust for Her Majesty unless it would be so regarded in the absence of that statutory provision.
>
> **18.3** (1) Subject to subsection (2), notwithstanding any provision in federal or provincial legislation that has the effect of deeming property to be held in trust for Her Majesty, property of a debtor company shall not be regarded as held in trust for Her Majesty unless it would be so regarded in the absence of that statutory provision.

131 The application of s. 44(*f*) of the *Interpretation Act* simply confirms the government's clearly expressed intent, found in Industry Canada's clause-by-clause review of Bill C-55, where s. 37(1) was identified as "a technical amendment to reorder the provisions of this Act". During second reading, the Hon. Bill Rompkey, then the Deputy Leader of the Government in the Senate, confirmed that s. 37(1) represented only a technical change:

> On a technical note relating to the treatment of deemed trusts for taxes, the bill [*sic*] makes no changes to the underlying policy intent, despite the fact that in the case of a restructuring under the CCAA, sections of the act [*sic*] were repealed and substituted with renumbered versions due to the extensive reworking of the CCAA.
>
> (*Debates of the Senate*, vol. 142, 1st Sess., 38th Parl., November 23, 2005, at p. 2147)

132 Had the substance of s. 18.3(1) altered in any material way when it was replaced by s. 37(1), I would share Deschamps J.'s view that it should be considered a new provision. But since s. 18.3(1) and s. 37(1) are the same in substance, the transformation of s. 18.3(1) into s. 37(1) has no effect on the interpretive queue, and s. 222(3) of the *ETA* remains the "later in time" provision (Sullivan, at p. 347).

133 This means that the deemed trust provision in s. 222(3) of the *ETA* takes precedence over s. 18.3(1) during *CCAA* proceedings. The question then is how that priority affects the discretion of a court under s. 11 of the *CCAA*.

134 While s. 11 gives a court discretion to make orders notwithstanding the *BIA* and the *Winding-up Act*, R.S.C. 1985, c. W-11, that discretion is not liberated from the operation of any other federal statute. Any exercise of discretion is therefore circumscribed by whatever limits are imposed by statutes *other* than the *BIA* and the *Winding-up Act*. That includes the *ETA*. The chambers judge in this case was, therefore, required to respect the priority regime set out in s. 222(3) of the *ETA*. Neither s. 18.3(1) nor s. 11 of the *CCAA* gave him the authority to ignore it. He could not, as a result, deny the Crown's request for payment of the GST funds during the *CCAA* proceedings.

135 Given this conclusion, it is unnecessary to consider whether there was an express trust.

136 I would dismiss the appeal.

Appeal allowed.

Pourvoi accueilli.

Appendix

***Companies' Creditors Arrangement Act*, R.S.C. 1985, c. C-36 (as at December 13, 2007)**

11. (1) Powers of court — 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.

...

(3) Initial application court orders — A court may, on an initial application in respect of a company, make an order on such terms as it may impose, effective for such period as the court deems necessary not exceeding thirty days,

(a) staying, until otherwise ordered by the court, all proceedings taken or that might be taken in respect of the company under an Act referred to in subsection (i);

(b) restraining, until otherwise ordered by the court, further proceedings in any action, suit or proceeding against the company; and

(c) prohibiting, until otherwise ordered by the court, the commencement of or proceeding with any other action, suit or proceeding against the company.

(4) Other than initial application court orders — A court may, on an application in respect of a company other than an initial application, make an order on such terms as it may impose,

(a) staying, until otherwise ordered by the court, for such period as the court deems necessary, all proceedings taken or that might be taken in respect of the company under an Act referred to in subsection (1);

(b) restraining, until otherwise ordered by the court, further proceedings in any action, suit or proceeding against the company; and

(c) prohibiting, until otherwise ordered by the court, the commencement of or proceeding with any other action, suit or proceeding against the company.

...

(6) Burden of proof on application — The court shall not make an order under subsection (3) or (4) unless

(a) the applicant satisfies the court that circumstances exist that make such an order appropriate; and

(b) in the case of an order under subsection (4), the applicant also satisfies the court that the applicant has acted, and is acting, in good faith and with due diligence.

11.4 (1) Her Majesty affected — An order made under section 11 may provide that

(a) Her Majesty in right of Canada may not exercise rights under subsection 224(1.2) of the *Income Tax Act* or any provision of the *Canada Pension Plan* or of the *Employment Insurance Act* that refers to subsection 224(1.2) of the *Income Tax Act* and provides for the collection of a contribution, as defined in the *Canada Pension Plan*, or an employee's premium, or employer's premium, as defined in the *Employment Insurance Act*, and of any related interest, penalties or other amounts, in respect of the company if the company is a tax debtor under that subsection or provision, for such period as the court considers appropriate but ending not later than

(i) the expiration of the order,

(ii) the refusal of a proposed compromise by the creditors or the court,

(iii) six months following the court sanction of a compromise or arrangement,

(iv) the default by the company on any term of a compromise or arrangement, or

(v) the performance of a compromise or arrangement in respect of the company; and\

(b) Her Majesty in right of a province may not exercise rights under any provision of provincial legislation in respect of the company where the company is a debtor under that legislation and the provision has a similar purpose to subsection 224(1.2) of the *Income Tax Act*, or refers to that subsection, to the extent that it provides for the collection of a sum, and of any related interest, penalties or other amounts, where the sum

(i) has been withheld or deducted by a person from a payment to another person and is in respect of a tax similar in nature to the income tax imposed on individuals under the *Income Tax Act*, or

(ii) is of the same nature as a contribution under the *Canada Pension Plan* if the province is a "province providing a comprehensive pension plan" as defined in subsection 3(1) of the *Canada Pension Plan* and the provincial legislation establishes a "provincial pension plan" as defined in that subsection,

for such period as the court considers appropriate but ending not later than the occurrence or time referred to in whichever of subparagraphs (*a*)(i) to (v) may apply.

(2) When order ceases to be in effect — An order referred to in subsection (1) ceases to be in effect if

(a) the company defaults on payment of any amount that becomes due to Her Majesty after the order is made and could be subject to a demand under

(i) subsection 224(1.2) of the *Income Tax Act*,

(ii) any provision of the *Canada Pension Plan* or of the *Employment Insurance Act* that refers to subsection 224(1.2) of the *Income Tax Act* and provides for the collection of a contribution, as defined in the *Canada Pension Plan*, or an employee's premium, or employer's premium, as defined in the *Employment Insurance Act*, and of any related interest, penalties or other amounts, or

(iii) under any provision of provincial legislation that has a similar purpose to subsection 224(1.2) of the *Income Tax Act*, or that refers to that subsection, to the extent that it provides for the collection of a sum, and of any related interest, penalties or other amounts, where the sum

(A) has been withheld or deducted by a person from a payment to another person and is in respect of a tax similar in nature to the income tax imposed on individuals under the *Income Tax Act*, or

(B) is of the same nature as a contribution under the *Canada Pension Plan* if the province is a "province providing a comprehensive pension plan" as defined in subsection 3(1) of the *Canada Pension Plan* and the provincial legislation establishes a "provincial pension plan" as defined in that subsection; or

(b) any other creditor is or becomes entitled to realize a security on any property that could be claimed by Her Majesty in exercising rights under

(i) subsection 224(1.2) of the *Income Tax Act*,

(ii) any provision of the *Canada Pension Plan* or of the *Employment Insurance Act* that refers to subsection 224(1.2) of the *Income Tax Act* and provides for the collection of a contribution, as defined in the *Canada Pension Plan*, or an employee's premium, or employer's premium, as defined in the *Employment Insurance Act*, and of any related interest, penalties or other amounts, or

(iii) any provision of provincial legislation that has a similar purpose to subsection 224(1.2) of the *Income Tax Act*, or that refers to that subsection, to the extent that it provides for the collection of a sum, and of any related interest, penalties or other amounts, where the sum

(A) has been withheld or deducted by a person from a payment to another person and is in respect of a tax similar in nature to the income tax imposed on individuals under the *Income Tax Act*, or

(B) is of the same nature as a contribution under the *Canada Pension Plan* if the province is a "province providing a comprehensive pension plan" as defined in subsection 3(1) of the *Canada Pension Plan* and the provincial legislation establishes a "provincial pension plan" as defined in that subsection.

(3) Operation of similar legislation — An order made under section 11, other than an order referred to in subsection (1) of this section, does not affect the operation of

(a) subsections 224(1.2) and (1.3) of the *Income Tax Act*,

(b) any provision of the *Canada Pension Plan* or of the *Employment Insurance Act* that refers to subsection 224(1.2) of the *Income Tax Act* and provides for the collection of a contribution, as defined in the *Canada Pension Plan*, or an employee's premium, or employer's premium, as defined in the *Employment Insurance Act*, and of any related interest, penalties or other amounts, or

(c) any provision of provincial legislation that has a similar purpose to subsection 224(1.2) of the *Income Tax Act*, or that refers to that subsection, to the extent that it provides for the collection of a sum, and of any related interest, penalties or other amounts, where the sum

(i) has been withheld or deducted by a person from a payment to another person and is in respect of a tax similar in nature to the income tax imposed on individuals under the *Income Tax Act*, or

(ii) is of the same nature as a contribution under the *Canada Pension Plan* if the province is a "province providing a comprehensive pension plan" as defined in subsection 3(1) of the *Canada Pension Plan* and the provincial legislation establishes a "provincial pension plan" as defined in that subsection,

and for the purpose of paragraph (*c*), the provision of provincial legislation is, despite any Act of Canada or of a province or any other law, deemed to have the same effect and scope against any creditor, however secured, as subsection 224(1.2) of the *Income Tax Act* in respect of a sum referred to in subparagraph (*c*)(i), or as subsection 23(2) of the *Canada Pension Plan* in respect of a sum referred to in subparagraph (*c*)(ii), and in respect of any related interest, penalties or other amounts.

18.3 (1) Deemed trusts — Subject to subsection (2), notwithstanding any provision in federal or provincial legislation that has the effect of deeming property to be held in trust for Her Majesty, property of a debtor company shall not be regarded as held in trust for Her Majesty unless it would be so regarded in the absence of that statutory provision.

(2) Exceptions — Subsection (1) does not apply in respect of amounts deemed to be held in trust under subsection 227(4) or (4.1) of the *Income Tax Act*, subsection 23(3) or (4) of the *Canada Pension Plan* or subsection 86(2) or (2.1) of the *Employment Insurance Act* (each of which is in this subsection referred to as a "federal provision") nor in respect of amounts deemed to be held in trust under any law of a province that creates a deemed trust the sole purpose of which is to ensure remittance to Her Majesty in right of the province of amounts deducted or withheld under a law of the province where

(a) that law of the province imposes a tax similar in nature to the tax imposed under the *Income Tax Act* and the amounts deducted or withheld under that law of the province are of the same nature as the amounts referred to in subsection 227(4) or (4.1) of the *Income Tax Act*, or

(b) the province is a "province providing a comprehensive pension plan" as defined in subsection 3(1) of the *Canada Pension Plan*, that law of the province establishes a "provincial pension plan" as defined in that subsection and the amounts deducted or withheld under that law of the province are of the same nature as amounts referred to in subsection 23(3) or (4) of the *Canada Pension Plan*,

and for the purpose of this subsection, any provision of a law of a province that creates a deemed trust is, notwithstanding any Act of Canada or of a province or any other law, deemed to have the same effect and scope against any creditor, however secured, as the corresponding federal provision.

18.4 (1) Status of Crown claims — In relation to a proceeding under this Act, all claims, including secured claims, of Her Majesty in right of Canada or a province or any body under an enactment respecting workers' compensation, in this section and in section 18.5 called a "workers' compensation body", rank as unsecured claims.

...

(3) Operation of similar legislation — Subsection (1) does not affect the operation of

(a) subsections 224(1.2) and (1.3) of the *Income Tax Act*,

(b) any provision of the *Canada Pension Plan* or of the *Employment Insurance Act* that refers to subsection 224(1.2) of the *Income Tax Act* and provides for the collection of a contribution, as defined in the *Canada Pension Plan*, or an employee's premium, or employer's premium, as defined in the *Employment Insurance Act*, and of any related interest, penalties or other amounts, or

(c) any provision of provincial legislation that has a similar purpose to subsection 224(1.2) of the *Income Tax Act*, or that refers to that subsection, to the extent that it provides for the collection of a sum, and of any related interest, penalties or other amounts, where the sum

(i) has been withheld or deducted by a person from a payment to another person and is in respect of a tax similar in nature to the income tax imposed on individuals under the *Income Tax Act*, or

(ii) is of the same nature as a contribution under the *Canada Pension Plan* if the province is a "province providing a comprehensive pension plan" as defined in subsection 3(1) of the *Canada Pension Plan* and the provincial legislation establishes a "provincial pension plan" as defined in that subsection,

and for the purpose of paragraph (*c*), the provision of provincial legislation is, despite any Act of Canada or of a province or any other law, deemed to have the same effect and scope against any creditor, however secured, as subsection 224(1.2) of the *Income Tax Act* in respect of a sum referred to in subparagraph (*c*)(i), or as subsection 23(2) of the *Canada Pension Plan* in respect of a sum referred to in subparagraph (*c*)(ii), and in respect of any related interest, penalties or other amounts.

...

20. [Act to be applied conjointly with other Acts] — The provisions of this Act may be applied together with the provisions of any Act of Parliament or of the legislature of any province, that authorizes or makes provision for the sanction of compromises or arrangements between a company and its shareholders or any class of them.

***Companies' Creditors Arrangement Act*, R.S.C. 1985, c. C-36 (as at September 18, 2009)**

11. General power of court — 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.

...

11.02 (1) Stays, etc. — initial application — A court may, on an initial application in respect of a debtor company, make an order on any terms that it may impose, effective for the period that the court considers necessary, which period may not be more than 30 days,

(a) staying, until otherwise ordered by the court, all proceedings taken or that might be taken in respect of the company under the *Bankruptcy and Insolvency Act* or the *Winding-up and Restructuring Act*;

(b) restraining, until otherwise ordered by the court, further proceedings in any action, suit or proceeding against the company; and

(c) prohibiting, until otherwise ordered by the court, the commencement of any action, suit or proceeding against the company.

(2) Stays, etc. — other than initial application — A court may, on an application in respect of a debtor company other than an initial application, make an order, on any terms that it may impose,

(a) staying, until otherwise ordered by the court, for any period that the court considers necessary, all proceedings taken or that might be taken in respect of the company under an Act referred to in paragraph (1)(*a*);

(b) restraining, until otherwise ordered by the court, further proceedings in any action, suit or proceeding against the company; and

(c) prohibiting, until otherwise ordered by the court, the commencement of any action, suit or proceeding against the company.

(3) Burden of proof on application — The court shall not make the order unless

(a) the applicant satisfies the court that circumstances exist that make the order appropriate; and

(b) in the case of an order under subsection (2), the applicant also satisfies the court that the applicant has acted, and is acting, in good faith and with due diligence.

...

11.09 (1) Stay — Her Majesty — An order made under section 11.02 may provide that

(a) Her Majesty in right of Canada may not exercise rights under subsection 224(1.2) of the *Income Tax Act* or any provision of the *Canada Pension Plan* or of the *Employment Insurance Act* that refers to subsection 224(1.2) of the *Income Tax Act* and provides for the collection of a contribution, as defined in the *Canada Pension Plan*, or an employee's premium, or employer's premium, as defined in the *Employment Insurance Act*, and of any related interest, penalties or other amounts, in respect of the company if the company is a tax debtor under that subsection or provision, for the period that the court considers appropriate but ending not later than

(i) the expiry of the order,

(ii) the refusal of a proposed compromise by the creditors or the court,

(iii) six months following the court sanction of a compromise or an arrangement,

(iv) the default by the company on any term of a compromise or an arrangement, or

(v) the performance of a compromise or an arrangement in respect of the company; and

(b) Her Majesty in right of a province may not exercise rights under any provision of provincial legislation in respect of the company if the company is a debtor under that legislation and the provision has a purpose similar to subsection 224(1.2) of the *Income Tax Act*, or refers to that subsection, to the extent that it provides for the collection of a sum, and of any related interest, penalties or other amounts, and the sum

(i) has been withheld or deducted by a person from a payment to another person and is in respect of a tax similar in nature to the income tax imposed on individuals under the *Income Tax Act*, or

(ii) is of the same nature as a contribution under the *Canada Pension Plan* if the province is a "province providing a comprehensive pension plan" as defined in subsection 3(1) of the *Canada Pension Plan* and the provincial legislation establishes a "provincial pension plan" as defined in that subsection,

for the period that the court considers appropriate but ending not later than the occurrence or time referred to in whichever of subparagraphs (*a*)(i) to (v) that may apply.

(2) When order ceases to be in effect — The portions of an order made under section 11.02 that affect the exercise of rights of Her Majesty referred to in paragraph (1)(*a*) or (*b*) cease to be in effect if

(a) the company defaults on the payment of any amount that becomes due to Her Majesty after the order is made and could be subject to a demand under

(i) subsection 224(1.2) of the *Income Tax Act*,

(ii) any provision of the *Canada Pension Plan* or of the *Employment Insurance Act* that refers to subsection 224(1.2) of the *Income Tax Act* and provides for the collection of a contribution, as defined in the *Canada Pension Plan*, or an employee's premium, or employer's premium, as defined in the *Employment Insurance Act*, and of any related interest, penalties or other amounts, or

(iii) any provision of provincial legislation that has a purpose similar to subsection 224(1.2) of the *Income Tax Act*, or that refers to that subsection, to the extent that it provides for the collection of a sum, and of any related interest, penalties or other amounts, and the sum

(A) has been withheld or deducted by a person from a payment to another person and is in respect of a tax similar in nature to the income tax imposed on individuals under the *Income Tax Act*, or

(B) is of the same nature as a contribution under the *Canada Pension Plan* if the province is a "province providing a comprehensive pension plan" as defined in subsection 3(1) of the *Canada Pension Plan* and the provincial legislation establishes a "provincial pension plan" as defined in that subsection; or

(b) any other creditor is or becomes entitled to realize a security on any property that could be claimed by Her Majesty in exercising rights under

(i) subsection 224(1.2) of the *Income Tax Act*,

(ii) any provision of the *Canada Pension Plan* or of the *Employment Insurance Act* that refers to subsection 224(1.2) of the *Income Tax Act* and provides for the collection of a contribution, as defined in the *Canada Pension Plan*, or an employee's premium, or employer's premium, as defined in the *Employment Insurance Act*, and of any related interest, penalties or other amounts, or

(iii) any provision of provincial legislation that has a purpose similar to subsection 224(1.2) of the *Income Tax Act*, or that refers to that subsection, to the extent that it provides for the collection of a sum, and of any related interest, penalties or other amounts, and the sum

(A) has been withheld or deducted by a person from a payment to another person and is in respect of a tax similar in nature to the income tax imposed on individuals under the *Income Tax Act*, or

(B) is of the same nature as a contribution under the *Canada Pension Plan* if the province is a "province providing a comprehensive pension plan" as defined in subsection 3(1) of the *Canada Pension Plan* and the provincial legislation establishes a "provincial pension plan" as defined in that subsection.

(3) Operation of similar legislation — An order made under section 11.02, other than the portions of that order that affect the exercise of rights of Her Majesty referred to in paragraph (1)(*a*) or (*b*), does not affect the operation of

(a) subsections 224(1.2) and (1.3) of the *Income Tax Act*,

(b) any provision of the *Canada Pension Plan* or of the *Employment Insurance Act* that refers to subsection 224(1.2) of the *Income Tax Act* and provides for the collection of a contribution, as defined in the *Canada*

Pension Plan, or an employee's premium, or employer's premium, as defined in the *Employment Insurance Act*, and of any related interest, penalties or other amounts, or

(c) any provision of provincial legislation that has a purpose similar to subsection 224(1.2) of the *Income Tax Act*, or that refers to that subsection, to the extent that it provides for the collection of a sum, and of any related interest, penalties or other amounts, and the sum

(i) has been withheld or deducted by a person from a payment to another person and is in respect of a tax similar in nature to the income tax imposed on individuals under the *Income Tax Act*, or

(ii) is of the same nature as a contribution under the *Canada Pension Plan* if the province is a "province providing a comprehensive pension plan" as defined in subsection 3(1) of the *Canada Pension Plan* and the provincial legislation establishes a "provincial pension plan" as defined in that subsection,

and for the purpose of paragraph (*c*), the provision of provincial legislation is, despite any Act of Canada or of a province or any other law, deemed to have the same effect and scope against any creditor, however secured, as subsection 224(1.2) of the *Income Tax Act* in respect of a sum referred to in subparagraph (*c*)(i), or as subsection 23(2) of the *Canada Pension Plan* in respect of a sum referred to in subparagraph (*c*)(ii), and in respect of any related interest, penalties or other amounts.

37. (1) Deemed trusts — Subject to subsection (2), despite any provision in federal or provincial legislation that has the effect of deeming property to be held in trust for Her Majesty, property of a debtor company shall not be regarded as being held in trust for Her Majesty unless it would be so regarded in the absence of that statutory provision.

(2) Exceptions — Subsection (1) does not apply in respect of amounts deemed to be held in trust under subsection 227(4) or (4.1) of the *Income Tax Act*, subsection 23(3) or (4) of the *Canada Pension Plan* or subsection 86(2) or (2.1) of the *Employment Insurance Act* (each of which is in this subsection referred to as a "federal provision"), nor does it apply in respect of amounts deemed to be held in trust under any law of a province that creates a deemed trust the sole purpose of which is to ensure remittance to Her Majesty in right of the province of amounts deducted or withheld under a law of the province if

(a) that law of the province imposes a tax similar in nature to the tax imposed under the *Income Tax Act* and the amounts deducted or withheld under that law of the province are of the same nature as the amounts referred to in subsection 227(4) or (4.1) of the *Income Tax Act*, or

(b) the province is a "province providing a comprehensive pension plan" as defined in subsection 3(1) of the *Canada Pension Plan*, that law of the province establishes a "provincial pension plan" as defined in that subsection and the amounts deducted or withheld under that law of the province are of the same nature as amounts referred to in subsection 23(3) or (4) of the *Canada Pension Plan*,

and for the purpose of this subsection, any provision of a law of a province that creates a deemed trust is, despite any Act of Canada or of a province or any other law, deemed to have the same effect and scope against any creditor, however secured, as the corresponding federal provision.

***Excise Tax Act*, R.S.C. 1985, c. E-15 (as at December 13, 2007)**

222. (1) [Deemed] Trust for amounts collected — Subject to subsection (1.1), every person who collects an amount as or on account of tax under Division II is deemed, for all purposes and despite any security interest in the amount, to hold the amount in trust for Her Majesty in right of Canada, separate and apart from the property of the person and from property held by any secured creditor of the person that, but for a security interest, would be property of the person, until the amount is remitted to the Receiver General or withdrawn under subsection (2).

(1.1) Amounts collected before bankruptcy — Subsection (1) does not apply, at or after the time a person becomes a bankrupt (within the meaning of the *Bankruptcy and Insolvency Act)*, to any amounts that, before that time, were collected or became collectible by the person as or on account of tax under Division II.

...

(3) Extension of trust — Despite any other provision of this Act (except subsection (4)), any other enactment of Canada (except the *Bankruptcy and Insolvency Act)*, any enactment of a province or any other law, if at any time an amount deemed by subsection (1) to be held by a person in trust for Her Majesty is not remitted to the Receiver General or withdrawn in the manner and at the time provided under this Part, property of the person and property held by any secured creditor of the person that, but for a security interest, would be property of the person, equal in value to the amount so deemed to be held in trust, is deemed

(a) to be held, from the time the amount was collected by the person, in trust for Her Majesty, separate and apart from the property of the person, whether or not the property is subject to a security interest, and

(b) to form no part of the estate or property of the person from the time the amount was collected, whether or not the property has in fact been kept separate and apart from the estate or property of the person and whether or not the property is subject to a security interest

and is property beneficially owned by Her Majesty in right of Canada despite any security interest in the property or in the proceeds thereof and the proceeds of the property shall be paid to the Receiver General in priority to all security interests.

***Bankruptcy and Insolvency Act*, R.S.C. 1985, c. B-3 (as at December 13, 2007)**

67. (1) Property of bankrupt — The property of a bankrupt divisible among his creditors shall not comprise

(a) property held by the bankrupt in trust for any other person,

(b) any property that as against the bankrupt is exempt from execution or seizure under any laws applicable in the province within which the property is situated and within which the bankrupt resides, or

(b.1) such goods and services tax credit payments and prescribed payments relating to the essential needs of an individual as are made in prescribed circumstances and are not property referred to in paragraph (*a*) or (*b*),

but it shall comprise

(c) all property wherever situated of the bankrupt at the date of his bankruptcy or that may be acquired by or devolve on him before his discharge, and

(d) such powers in or over or in respect of the property as might have been exercised by the bankrupt for his own benefit.

(2) Deemed trusts — Subject to subsection (3), notwithstanding any provision in federal or provincial legislation that has the effect of deeming property to be held in trust for Her Majesty, property of a bankrupt shall not be regarded as held in trust for Her Majesty for the purpose of paragraph (1)(*a*) unless it would be so regarded in the absence of that statutory provision.

(3) Exceptions — Subsection (2) does not apply in respect of amounts deemed to be held in trust under subsection 227(4) or (4.1) of the *Income Tax Act*, subsection 23(3) or (4) of the *Canada Pension Plan* or subsection 86(2) or (2.1) of the *Employment Insurance Act* (each of which is in this subsection referred to as a "federal provision") nor in respect of amounts deemed to be held in trust under any law of a province that creates a deemed trust the sole

purpose of which is to ensure remittance to Her Majesty in right of the province of amounts deducted or withheld under a law of the province where

(a) that law of the province imposes a tax similar in nature to the tax imposed under the *Income Tax Act* and the amounts deducted or withheld under that law of the province are of the same nature as the amounts referred to in subsection 227(4) or (4.1) of the *Income Tax Act*, or

(b) the province is a "province providing a comprehensive pension plan" as defined in subsection 3(1) of the *Canada Pension Plan*, that law of the province establishes a "provincial pension plan" as defined in that subsection and the amounts deducted or withheld under that law of the province are of the same nature as amounts referred to in subsection 23(3) or (4) of the *Canada Pension Plan*,

and for the purpose of this subsection, any provision of a law of a province that creates a deemed trust is, notwithstanding any Act of Canada or of a province or any other law, deemed to have the same effect and scope against any creditor, however secured, as the corresponding federal provision.

86. (1) Status of Crown claims — In relation to a bankruptcy or proposal, all provable claims, including secured claims, of Her Majesty in right of Canada or a province or of any body under an Act respecting workers' compensation, in this section and in section 87 called a "workers' compensation body", rank as unsecured claims.

...

(3) Exceptions — Subsection (1) does not affect the operation of

(a) subsections 224(1.2) and (1.3) of the *Income Tax Act*;

(b) any provision of the *Canada Pension Plan* or of the *Employment Insurance Act* that refers to subsection 224(1.2) of the *Income Tax Act* and provides for the collection of a contribution, as defined in the *Canada Pension Plan*, or an employee's premium, or employer's premium, as defined in the *Employment Insurance Act*, and of any related interest, penalties or other amounts; or

(c) any provision of provincial legislation that has a similar purpose to subsection 224(1.2) of the *Income Tax Act*, or that refers to that subsection, to the extent that it provides for the collection of a sum, and of any related interest, penalties or other amounts, where the sum

(i) has been withheld or deducted by a person from a payment to another person and is in respect of a tax similar in nature to the income tax imposed on individuals under the *Income Tax Act*, or

(ii) is of the same nature as a contribution under the *Canada Pension Plan* if the province is a "province providing a comprehensive pension plan" as defined in subsection 3(1) of the *Canada Pension Plan* and the provincial legislation establishes a "provincial pension plan" as defined in that subsection,

and for the purpose of paragraph (*c*), the provision of provincial legislation is, despite any Act of Canada or of a province or any other law, deemed to have the same effect and scope against any creditor, however secured, as subsection 224(1.2) of the *Income Tax Act* in respect of a sum referred to in subparagraph (*c*)(i), or as subsection 23(2) of the *Canada Pension Plan* in respect of a sum referred to in subparagraph (*c*)(ii), and in respect of any related interest, penalties or other amounts.

Footnotes

1 Section 11 was amended, effective September 18, 2009, and now states:

11. 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.

2 The amendments did not come into force until September 18, 2009.

End of Document

TAB 21

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.

Table of Authorities

Cases considered:

Amirault Fish Co., Re, 32 C.B.R. 186, [1951] 4 D.L.R. 203 (N.S. T.D.) — *referred to*

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*

Empire-Universal Films Ltd. v. Rank, [1947] O.R. 775 [H.C.] — *referred to*

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

Fine's Flowers Ltd. v. Fine's Flowers (Creditors of) (1992), 10 C.B.R. (3d) 87, 4 B.L.R. (2d) 293, 87 D.L.R. (4th) 391, 7 O.R. (3d) 193 (Gen. Div.) — *referred to*

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*

Hongkong Bank of Canada v. Chef Ready Foods Ltd. (1990), 4 C.B.R. (3d) 311, 51 B.C.L.R. (2d) 84, [1991] 2 W.W.R. 136 (C.A.) — *referred to*

Inducon Development Corp. Re (1992), 8 C.B.R. (3d) 306 (Ont. Gen. Div.) — *referred to*

International Donut Corp. v. 050863 N.B. Ltd. (1992), 127 N.B.R. (2d) 290, 319 A.P.R. 290 (Q.B.) — *considered*

Keppoch Development Ltd., Re (1991), 8 C.B.R. (3d) 95 (N.S. T.D.) — *referred to*

Langley's Ltd., Re, [1938] O.R. 123, [1938] 3 D.L.R. 230 (C.A.) — *referred to*

McCordic v. Bosanquet (1974), 5 O.R. (2d) 53 (H.C.) — *referred to*

Meridian Developments Inc. v. Toronto Dominion Bank, 52 C.B.R. (N.S.) 109, [1984] 5 W.W.R. 215, 32 Alta. L.R. (2d) 150, 53 A.R. 39, 11 D.L.R. (4th) 576 (Q.B.) — *referred to*

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. 1 (Q.B.) — *referred to*

Northland Properties Ltd., Re (1988), 73 C.B.R. (N.S.) 141 (B.C. S.C.) — *referred to*

Nova Metal Products Inc. v. Comiskey (Trustee of) (1990), 1 C.B.R. (3d) 101, (sub nom. *Elan Corp. v. Comiskey)* 41 O.A.C. 282, 1 O.R. (3d) 289 (C.A.) — *referred to*

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*

Seven Mile Dam Contractors v. R. (1979), 13 B.C.L.R. 137, 104 D.L.R. (3d) 274 (S.C.) , affirmed (1980), 25 B.C.L.R. 183 (C.A.) — *referred to*

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.) .
>
> .....
>
> 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

TAB 22

TAB A

2008 ONCA 587
Ontario Court of Appeal

ATB Financial v. Metcalfe & Mansfield Alternative Investments II Corp.

2008 CarswellOnt 4811, 2008 ONCA 587, [2008] O.J. No. 3164, 168 A.C.W.S. (3d) 698, 240 O.A.C. 245, 296 D.L.R. (4th) 135, 45 C.B.R. (5th) 163, 47 B.L.R. (4th) 123, 92 O.R. (3d) 513

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 AND ARRANGEMENT INVOLVING METCALFE & MANSFIELD ALTERNATIVE INVESTMENTS II CORP., METCALFE & MANSFIELD ALTERNATIVE INVESTMENTS III CORP., METCALFE & MANSFIELD ALTERNATIVE INVESTMENTS V CORP., METCALFE & MANSFIELD ALTERNATIVE INVESTMENTS XI CORP., METCALFE & MANSFIELD ALTERNATIVE INVESTMENTS XII CORP., 4446372 CANADA INC. AND 6932819 CANADA INC., TRUSTEES OF THE CONDUITS LISTED IN SCHEDULE "A" HERETO

THE INVESTORS REPRESENTED ON THE PAN-CANADIAN INVESTORS COMMITTEE FOR THIRD-PARTY STRUCTURED ASSET-BACKED COMMERCIAL PAPER LISTED IN SCHEDULE "B" HERETO (Applicants / Respondents in Appeal) and METCALFE & MANSFIELD ALTERNATIVE INVESTMENTS II CORP., METCALFE & MANSFIELD ALTERNATIVE INVESTMENTS III CORP., METCALFE & MANSFIELD ALTERNATIVE INVESTMENTS V CORP., METCALFE & MANSFIELD ALTERNATIVE INVESTMENTS XI CORP., METCALFE & MANSFIELD ALTERNATIVE INVESTMENTS XII CORP., 4446372 CANADA INC. AND 6932819 CANADA INC., TRUSTEES OF THE CONDUITS LISTED IN SCHEDULE "A" HERETO (Respondents / Respondents in Appeal) and AIR TRANSAT A.T. INC., TRANSAT TOURS CANADA INC., THE JEAN COUTU GROUP (PJC) INC., AÉROPORTS DE MONTRÉAL INC., AÉROPORTS DE MONTRÉAL CAPITAL INC., POMERLEAU ONTARIO INC., POMERLEAU INC., LABOPHARM INC., DOMTAR INC., DOMTAR PULP AND PAPER PRODUCTS INC., GIRO INC., VÊTEMENTS DE SPORTS R.G.R. INC., 131519 CANADA INC., AIR JAZZ LP, PETRIFOND FOUNDATION COMPANY LIMITED, PETRIFOND FOUNDATION MIDWEST LIMITED, SERVICES HYPOTHÉCAIRES LA PATRIMONIALE INC., TECSYS INC. SOCIÉTÉ GÉNÉRALE DE FINANCEMENT DU QUÉBEC, VIBROSYSTM INC., INTERQUISA CANADA L.P., REDCORP VENTURES LTD., JURA ENERGY CORPORATION, IVANHOE MINES LTD., WEBTECH WIRELESS INC., WYNN CAPITAL CORPORATION INC., HY BLOOM INC., CARDACIAN MORTGAGE SERVICES, INC., WEST ENERGY LTD., SABRE ENERTY LTD., PETROLIFERA PETROLEUM LTD., VAQUERO RESOURCES LTD. and STANDARD ENERGY INC. (Respondents / Appellants)

J.I. Laskin, E.A. Cronk, R.A. Blair JJ.A.

Heard: June 25-26, 2008
Judgment: August 18, 2008 *
Docket: CA C48969

Proceedings: affirming *ATB Financial v. Metcalfe & Mansfield Alternative Investments II Corp.* (2008), 2008 CarswellOnt 3523, 43 C.B.R. (5th) 269 (Ont. S.C.J. [Commercial List])

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Thomas McRae, Arthur O. Jacques for Ad Hoc Retail Creditors Committee (Brian Hunter, et al)
Howard Shapray, Q.C., Stephen Fitterman for Ivanhoe Mines Ltd.
Kevin P. McElcheran, Heather L. Meredith for Canadian Banks, BMO, CIBC RBC, Bank of Nova Scotia, T.D. Bank
Jeffrey S. Leon for CIBC Mellon Trust Company, Computershare Trust Company of Canada, BNY Trust Company of Canada, as Indenture Trustees
Usman Sheikh for Coventree Capital Inc.
Allan Sternberg, Sam R. Sasso for Brookfield Asset Management and Partners Ltd., Hy Bloom Inc., Cardacian Mortgage Services Inc.
Neil C. Saxe for Dominion Bond Rating Service
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Scott A. Turner for Webtech Wireless Inc., Wynn Capital Corporation Inc., West Energy Ltd., Sabre Energy Ltd., Petrolifera Petroleum Ltd., Vaquero Resources Ltd., and Standard Energy Ltd.
R. Graham Phoenix for Metcalfe & Mansfield Alternative Investments II Corp., Metcalfe & Mansfield Alternative Investments III Corp., Metcalfe & Mansfield Alternative Investments V Corp., Metcalfe & Mansfield Alternative Investments XI Corp., Metcalfe & Mansfield Alternative Investments XII Corp., Quanto Financial Corporation and Metcalfe & Mansfield Capital Corp.

Subject: Insolvency; Civil Practice and Procedure

Headnote

Bankruptcy and insolvency --- Proposal — Companies' Creditors Arrangement Act — Arrangements — Approval by court — Miscellaneous issues

Releases — Parties were financial institutions, dealers and noteholders in market for Asset Backed Commercial Paper ("ABCP") — Canadian ABCP market experienced liquidity crisis — Plan of Compromise and Arrangement ("Plan") was put forward under Companies' Creditors Arrangement Act ("CCAA") — Plan included releases for claims against banks and dealers in negligence, misrepresentation and fraud, with "carve out" allowing fraudulent misrepresentations claims — Noteholders voted in favour of Plan — Minority noteholders ("opponents") opposed Plan based on releases — Applicants' application for approval of Plan was granted — Opponents brought application for leave to appeal and appeal from that decision — Application granted; appeal dismissed — CCAA permits inclusion of third party releases in plan of compromise or arrangement to be sanctioned by court where those releases were reasonably connected to proposed restructuring — It is implicit in language of CCAA that court has authority to sanction plans incorporating third-party releases that are reasonably related to proposed restructuring — CCAA is supporting framework for resolution of corporate insolvencies in public interest — Parties are entitled to put anything in Plan that could lawfully be incorporated into any contract — Plan of compromise or arrangement may propose that creditors agree to compromise claims against debtor and to release third parties, just as any debtor and creditor might agree to such terms in contract between them — Once statutory mechanism regarding voter approval and court sanctioning has been complied with, plan becomes binding on all creditors.

Bankruptcy and insolvency --- Practice and procedure in courts — Appeals — To Court of Appeal — Availability — Miscellaneous cases

Leave to appeal — Parties were financial institutions, dealers and noteholders in market for Asset Backed Commercial Paper ("ABCP") — Canadian ABCP market experienced liquidity crisis — Plan of Compromise and Arrangement ("Plan") was put forward under Companies' Creditors Arrangement Act ("CCAA") — Plan included releases for claims against banks and dealers in negligence, misrepresentation and fraud, with "carve out" allowing fraudulent misrepresentations claims — Noteholders voted in favour of Plan — Minority noteholders ("opponents") opposed Plan based on releases — Applicants' application for approval of Plan was granted — Opponents brought application for leave to appeal and appeal from that decision — Application granted; appeal dismissed — Criteria for granting leave to appeal in CCAA proceedings was met — Proposed appeal raised issues of considerable importance to restructuring proceedings under CCAA Canada-wide — These were serious and arguable grounds of appeal and appeal would not unduly delay progress of proceedings.

Table of Authorities

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s. 4 — considered

s. 5.1 [en. 1997, c. 12, s. 122] — considered

s. 6 — considered

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s. 91 ¶ 21 — referred to

s. 92 — referred to

s. 92 ¶ 13 — referred to

Words and phrases considered:

arrangement

"Arrangement" is broader than "compromise" and would appear to include any scheme for reorganizing the affairs of the debtor.

APPEAL by opponents of creditor-initiated plan from judgment reported at *ATB Financial v. Metcalfe & Mansfield Alternative Investments II Corp.* (2008), 2008 CarswellOnt 3523, 43 C.B.R. (5th) 269, 47 B.L.R. (4th) 74 (Ont. S.C.J. [Commercial List]), granting application for approval of plan.

***R.A. Blair J.A.*:**

A. Introduction

1 In August 2007 a liquidity crisis suddenly threatened the Canadian market in Asset Backed Commercial Paper ("ABCP"). The crisis was triggered by a loss of confidence amongst investors stemming from the news of widespread defaults on U.S. sub-prime mortgages. The loss of confidence placed the Canadian financial market at risk generally and was reflective of an economic volatility worldwide.

2 By agreement amongst the major Canadian participants, the $32 billion Canadian market in third-party ABCP was frozen on August 13, 2007 pending an attempt to resolve the crisis through a restructuring of that market. The Pan-Canadian Investors Committee, chaired by Purdy Crawford, C.C., Q.C., was formed and ultimately put forward the creditor-initiated Plan of Compromise and Arrangement that forms the subject-matter of these proceedings. The Plan was sanctioned by Colin L. Campbell J. on June 5, 2008.

3 Certain creditors who opposed the Plan seek leave to appeal and, if leave is granted, appeal from that decision. They raise an important point regarding the permissible scope of a restructuring under the *Companies' Creditors Arrangement Act*, R.S.C. 1985, c. C-36 as amended ("CCAA"): can the court sanction a Plan that calls for creditors to provide releases to third parties who are themselves solvent and not creditors of the debtor company? They also argue that, if the answer to this question is yes, the application judge erred in holding that this Plan, with its particular releases (which bar some claims even in fraud), was fair and reasonable and therefore in sanctioning it under the CCAA.

Leave to Appeal

4 Because of the particular circumstances and urgency of these proceedings, the court agreed to collapse an oral hearing for leave to appeal with the hearing of the appeal itself. At the outset of argument we encouraged counsel to combine their submissions on both matters.

5 The proposed appeal raises issues of considerable importance to restructuring proceedings under the CCAA Canada-wide. There are serious and arguable grounds of appeal and — given the expedited time-table — the appeal will not unduly delay the progress of the proceedings. I am satisfied that the criteria for granting leave to appeal in CCAA

proceedings, set out in such cases as *Cineplex Odeon Corp., Re* (2001), 24 C.B.R. (4th) 201 (Ont. C.A.), and *Country Style Food Services Inc., Re* (2002), 158 O.A.C. 30 (Ont. C.A. [In Chambers]), are met. I would grant leave to appeal.

Appeal

6 For the reasons that follow, however, I would dismiss the appeal.

B. Facts

The Parties

7 The appellants are holders of ABCP Notes who oppose the Plan. They do so principally on the basis that it requires them to grant releases to third party financial institutions against whom they say they have claims for relief arising out of their purchase of ABCP Notes. Amongst them are an airline, a tour operator, a mining company, a wireless provider, a pharmaceuticals retailer, and several holding companies and energy companies.

8 Each of the appellants has large sums invested in ABCP — in some cases, hundreds of millions of dollars. Nonetheless, the collective holdings of the appellants — slightly over $1 billion — represent only a small fraction of the more than $32 billion of ABCP involved in the restructuring.

9 The lead respondent is the Pan-Canadian Investors Committee which was responsible for the creation and negotiation of the Plan on behalf of the creditors. Other respondents include various major international financial institutions, the five largest Canadian banks, several trust companies, and some smaller holders of ABCP product. They participated in the market in a number of different ways.

The ABCP Market

10 Asset Backed Commercial Paper is a sophisticated and hitherto well-accepted financial instrument. It is primarily a form of short-term investment — usually 30 to 90 days — typically with a low interest yield only slightly better than that available through other short-term paper from a government or bank. It is said to be "asset backed" because the cash that is used to purchase an ABCP Note is converted into a portfolio of financial assets or other asset interests that in turn provide security for the repayment of the notes.

11 ABCP was often presented by those selling it as a safe investment, somewhat like a guaranteed investment certificate.

12 The Canadian market for ABCP is significant and administratively complex. As of August 2007, investors had placed over $116 billion in Canadian ABCP. Investors range from individual pensioners to large institutional bodies. On the selling and distribution end, numerous players are involved, including chartered banks, investment houses and other financial institutions. Some of these players participated in multiple ways. The Plan in this proceeding relates to approximately $32 billion of non-bank sponsored ABCP the restructuring of which is considered essential to the preservation of the Canadian ABCP market.

13 As I understand it, prior to August 2007 when it was frozen, the ABCP market worked as follows.

14 Various corporations (the "Sponsors") would arrange for entities they control ("Conduits") to make ABCP Notes available to be sold to investors through "Dealers" (banks and other investment dealers). Typically, ABCP was issued by series and sometimes by classes within a series.

15 The cash from the purchase of the ABCP Notes was used to purchase assets which were held by trustees of the Conduits ("Issuer Trustees") and which stood as security for repayment of the notes. Financial institutions that sold or provided the Conduits with the assets that secured the ABCP are known as "Asset Providers". To help ensure that investors would be able to redeem their notes, "Liquidity Providers" agreed to provide funds that could be drawn upon to meet the demands of maturing ABCP Notes in certain circumstances. Most Asset Providers were also Liquidity

Providers. Many of these banks and financial institutions were also holders of ABCP Notes ("Noteholders"). The Asset and Liquidity Providers held first charges on the assets.

16 When the market was working well, cash from the purchase of new ABCP Notes was also used to pay off maturing ABCP Notes; alternatively, Noteholders simply rolled their maturing notes over into new ones. As I will explain, however, there was a potential underlying predicament with this scheme.

The Liquidity Crisis

17 The types of assets and asset interests acquired to "back" the ABCP Notes are varied and complex. They were generally long-term assets such as residential mortgages, credit card receivables, auto loans, cash collateralized debt obligations and derivative investments such as credit default swaps. Their particular characteristics do not matter for the purpose of this appeal, but they shared a common feature that proved to be the Achilles heel of the ABCP market: because of their long-term nature there was an inherent timing mismatch between the cash they generated and the cash needed to repay maturing ABCP Notes.

18 When uncertainty began to spread through the ABCP marketplace in the summer of 2007, investors stopped buying the ABCP product and existing Noteholders ceased to roll over their maturing notes. There was no cash to redeem those notes. Although calls were made on the Liquidity Providers for payment, most of the Liquidity Providers declined to fund the redemption of the notes, arguing that the conditions for liquidity funding had not been met in the circumstances. Hence the "liquidity crisis" in the ABCP market.

19 The crisis was fuelled largely by a lack of transparency in the ABCP scheme. Investors could not tell what assets were backing their notes — partly because the ABCP Notes were often sold before or at the same time as the assets backing them were acquired; partly because of the sheer complexity of certain of the underlying assets; and partly because of assertions of confidentiality by those involved with the assets. As fears arising from the spreading U.S. sub-prime mortgage crisis mushroomed, investors became increasingly concerned that their ABCP Notes may be supported by those crumbling assets. For the reasons outlined above, however, they were unable to redeem their maturing ABCP Notes.

The Montreal Protocol

20 The liquidity crisis could have triggered a wholesale liquidation of the assets, at depressed prices. But it did not. During the week of August 13, 2007, the ABCP market in Canada froze — the result of a standstill arrangement orchestrated on the heels of the crisis by numerous market participants, including Asset Providers, Liquidity Providers, Noteholders and other financial industry representatives. Under the standstill agreement — known as the Montréal Protocol — the parties committed to restructuring the ABCP market with a view, as much as possible, to preserving the value of the assets and of the notes.

21 The work of implementing the restructuring fell to the Pan-Canadian Investors Committee, an applicant in the proceeding and respondent in the appeal. The Committee is composed of 17 financial and investment institutions, including chartered banks, credit unions, a pension board, a Crown corporation, and a university board of governors. All 17 members are themselves Noteholders; three of them also participated in the ABCP market in other capacities as well. Between them, they hold about two thirds of the $32 billion of ABCP sought to be restructured in these proceedings.

22 Mr. Crawford was named the Committee's chair. He thus had a unique vantage point on the work of the Committee and the restructuring process as a whole. His lengthy affidavit strongly informed the application judge's understanding of the factual context, and our own. He was not cross-examined and his evidence is unchallenged.

23 Beginning in September 2007, the Committee worked to craft a plan that would preserve the value of the notes and assets, satisfy the various stakeholders to the extent possible, and restore confidence in an important segment of the Canadian financial marketplace. In March 2008, it and the other applicants sought CCAA protection for the

ABCP debtors and the approval of a Plan that had been pre-negotiated with some, but not all, of those affected by the misfortunes in the Canadian ABCP market.

The Plan

a) Plan Overview

24 Although the ABCP market involves many different players and kinds of assets, each with their own challenges, the committee opted for a single plan. In Mr. Crawford's words, "all of the ABCP suffers from common problems that are best addressed by a common solution." The Plan the Committee developed is highly complex and involves many parties. In its essence, the Plan would convert the Noteholders' paper — which has been frozen and therefore effectively worthless for many months — into new, long-term notes that would trade freely, but with a discounted face value. The hope is that a strong secondary market for the notes will emerge in the long run.

25 The Plan aims to improve transparency by providing investors with detailed information about the assets supporting their ABCP Notes. It also addresses the timing mismatch between the notes and the assets by adjusting the maturity provisions and interest rates on the new notes. Further, the Plan adjusts some of the underlying credit default swap contracts by increasing the thresholds for default triggering events; in this way, the likelihood of a forced liquidation flowing from the credit default swap holder's prior security is reduced and, in turn, the risk for ABCP investors is decreased.

26 Under the Plan, the vast majority of the assets underlying ABCP would be pooled into two master asset vehicles (MAV1 and MAV2). The pooling is designed to increase the collateral available and thus make the notes more secure.

27 The Plan does not apply to investors holding less than $1 million of notes. However, certain Dealers have agreed to buy the ABCP of those of their customers holding less than the $1-million threshold, and to extend financial assistance to these customers. Principal among these Dealers are National Bank and Canaccord, two of the respondent financial institutions the appellants most object to releasing. The application judge found that these developments appeared to be designed to secure votes in favour of the Plan by various Noteholders, and were apparently successful in doing so. If the Plan is approved, they also provide considerable relief to the many small investors who find themselves unwittingly caught in the ABDP collapse.

b) The Releases

28 This appeal focuses on one specific aspect of the Plan: the comprehensive series of releases of third parties provided for in Article 10.

29 The Plan calls for the release of Canadian banks, Dealers, Noteholders, Asset Providers, Issuer Trustees, Liquidity Providers, and other market participants — in Mr. Crawford's words, "virtually all participants in the Canadian ABCP market" — from any liability associated with ABCP, with the exception of certain narrow claims relating to fraud. For instance, under the Plan as approved, creditors will have to give up their claims against the Dealers who sold them their ABCP Notes, including challenges to the way the Dealers characterized the ABCP and provided (or did not provide) information about the ABCP. The claims against the proposed defendants are mainly in tort: negligence, misrepresentation, negligent misrepresentation, failure to act prudently as a dealer/advisor, acting in conflict of interest, and in a few cases fraud or potential fraud. There are also allegations of breach of fiduciary duty and claims for other equitable relief.

30 The application judge found that, in general, the claims for damages include the face value of the Notes, plus interest and additional penalties and damages.

31 The releases, in effect, are part of a *quid pro quo*. Generally speaking, they are designed to compensate various participants in the market for the contributions they would make to the restructuring. Those contributions under the Plan include the requirements that:

> a) Asset Providers assume an increased risk in their credit default swap contracts, disclose certain proprietary information in relation to the assets, and provide below-cost financing for margin funding facilities that are designed to make the notes more secure;
>
> b) Sponsors — who in addition have cooperated with the Investors' Committee throughout the process, including by sharing certain proprietary information — give up their existing contracts;
>
> c) The Canadian banks provide below-cost financing for the margin funding facility and,
>
> d) Other parties make other contributions under the Plan.

32 According to Mr. Crawford's affidavit, the releases are part of the Plan "because certain key participants, whose participation is vital to the restructuring, have made comprehensive releases a condition for their participation."

The CCAA Proceedings to Date

33 On March 17, 2008 the applicants sought and obtained an Initial Order under the CCAA staying any proceedings relating to the ABCP crisis and providing for a meeting of the Noteholders to vote on the proposed Plan. The meeting was held on April 25 th . The vote was overwhelmingly in support of the Plan — 96% of the Noteholders voted in favour. At the instance of certain Noteholders, and as requested by the application judge (who has supervised the proceedings from the outset), the Monitor broke down the voting results according to those Noteholders who had worked on or with the Investors' Committee to develop the Plan and those Noteholders who had not. Re-calculated on this basis the results remained firmly in favour of the proposed Plan — 99% of those connected with the development of the Plan voted positively, as did 80% of those Noteholders who had not been involved in its formulation.

34 The vote thus provided the Plan with the "double majority" approval — a majority of creditors representing two-thirds in value of the claims — required under s. 6 of the CCAA.

35 Following the successful vote, the applicants sought court approval of the Plan under s. 6. Hearings were held on May 12 and 13. On May 16, the application judge issued a brief endorsement in which he concluded that he did not have sufficient facts to decide whether all the releases proposed in the Plan were authorized by the CCAA. While the application judge was prepared to approve the releases of negligence claims, he was not prepared at that point to sanction the release of fraud claims. Noting the urgency of the situation and the serious consequences that would result from the Plan's failure, the application judge nevertheless directed the parties back to the bargaining table to try to work out a claims process for addressing legitimate claims of fraud.

36 The result of this renegotiation was a "fraud carve-out" — an amendment to the Plan excluding certain fraud claims from the Plan's releases. The carve-out did not encompass all possible claims of fraud, however. It was limited in three key respects. First, it applied only to claims against ABCP Dealers. Secondly, it applied only to cases involving an express fraudulent misrepresentation made with the intention to induce purchase and in circumstances where the person making the representation knew it to be false. Thirdly, the carve-out limited available damages to the value of the notes, minus any funds distributed as part of the Plan. The appellants argue vigorously that such a limited release respecting fraud claims is unacceptable and should not have been sanctioned by the application judge.

37 A second sanction hearing — this time involving the amended Plan (with the fraud carve-out) — was held on June 3, 2008. Two days later, Campbell J. released his reasons for decision, approving and sanctioning the Plan on the basis

both that he had jurisdiction to sanction a Plan calling for third-party releases and that the Plan including the third-party releases in question here was fair and reasonable.

38 The appellants attack both of these determinations.

C. Law and Analysis

39 There are two principal questions for determination on this appeal:

> 1) As a matter of law, may a CCAA plan contain a release of claims against anyone other than the debtor company or its directors?
>
> 2) If the answer to that question is yes, did the application judge err in the exercise of his discretion to sanction the Plan as fair and reasonable given the nature of the releases called for under it?

(1) Legal Authority for the Releases

40 The standard of review on this first issue — whether, as a matter of law, a CCAA plan may contain third-party releases — is correctness.

41 The appellants submit that a court has no jurisdiction or legal authority under the CCAA to sanction a plan that imposes an obligation on creditors to give releases to third parties other than the directors of the debtor company. [1] The requirement that objecting creditors release claims against third parties is illegal, they contend, because:

> a) on a proper interpretation, the CCAA does not permit such releases;
>
> b) the court is not entitled to "fill in the gaps" in the CCAA or rely upon its inherent jurisdiction to create such authority because to do so would be contrary to the principle that Parliament did not intend to interfere with private property rights or rights of action in the absence of clear statutory language to that effect;
>
> c) the releases constitute an unconstitutional confiscation of private property that is within the exclusive domain of the provinces under s. 92 of the *Constitution Act*, 1867;
>
> d) the releases are invalid under Quebec rules of public order; and because
>
> e) the prevailing jurisprudence supports these conclusions.

42 I would not give effect to any of these submissions.

Interpretation, "Gap Filling" and Inherent Jurisdiction

43 On a proper interpretation, in my view, the CCAA permits the inclusion of third party releases in a plan of compromise or arrangement to be sanctioned by the court where those releases are reasonably connected to the proposed restructuring. I am led to this conclusion by a combination of (a) the open-ended, flexible character of the CCAA itself, (b) the broad nature of the term "compromise or arrangement" as used in the Act, and (c) the express statutory effect of the "double-majority" vote and court sanction which render the plan binding on *all* creditors, including those unwilling to accept certain portions of it. The first of these signals a flexible approach to the application of the Act in new and evolving situations, an active judicial role in its application and interpretation, and a liberal approach to that interpretation. The second provides the entrée to negotiations between the parties affected in the restructuring and furnishes them with the ability to apply the broad scope of their ingenuity in fashioning the proposal. The latter afford necessary protection to unwilling creditors who may be deprived of certain of their civil and property rights as a result of the process.

44 The CCAA is skeletal in nature. It does not contain a comprehensive code that lays out all that is permitted or barred. Judges must therefore play a role in fleshing out the details of the statutory scheme. The scope of the Act and the

powers of the court under it are not limitless. It is beyond controversy, however, that the CCAA is remedial legislation to be liberally construed in accordance with the modern purposive approach to statutory interpretation. It is designed to be a flexible instrument and it is that very flexibility which gives the Act its efficacy: *Canadian Red Cross Society / Société Canadienne de la Croix-Rouge, Re* (1998), 5 C.B.R. (4th) 299 (Ont. Gen. Div. [Commercial List]). As Farley J. noted in *Dylex Ltd., Re* (1995), 31 C.B.R. (3d) 106 (Ont. Gen. Div. [Commercial List]), at 111, "[t]he history of CCAA law has been an evolution of judicial interpretation."

45 Much has been said, however, about the "evolution of judicial interpretation" and there is some controversy over both the source and scope of that authority. Is the source of the court's authority statutory, discerned solely through application of the principles of statutory interpretation, for example? Or does it rest in the court's ability to "fill in the gaps" in legislation? Or in the court's inherent jurisdiction?

46 These issues have recently been canvassed by the Honourable Georgina R. Jackson and Dr. Janis Sarra in their publication "Selecting the Judicial Tool to get the Job Done: An Examination of Statutory Interpretation, Discretionary Power and Inherent Jurisdiction in Insolvency Matters," [2] and there was considerable argument on these issues before the application judge and before us. While I generally agree with the authors' suggestion that the courts should adopt a hierarchical approach in their resort to these interpretive tools — statutory interpretation, gap-filling, discretion and inherent jurisdiction — it is not necessary in my view to go beyond the general principles of statutory interpretation to resolve the issues on this appeal. Because I am satisfied that it is implicit in the language of the CCAA itself that the court has authority to sanction plans incorporating third-party releases that are reasonably related to the proposed restructuring, there is no "gap-filling" to be done and no need to fall back on inherent jurisdiction. In this respect, I take a somewhat different approach than the application judge did.

47 The Supreme Court of Canada has affirmed generally — and in the insolvency context particularly — that remedial statutes are to be interpreted liberally and in accordance with Professor Driedger's modern principle of statutory interpretation. Driedger advocated 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": *Rizzo & Rizzo Shoes Ltd., Re*, [1998] 1 S.C.R. 27 (S.C.C.) at para. 21, quoting E.A. Driedger, *Construction of Statutes*, 2nd ed. (Toronto: Butterworths, 1983); *Bell ExpressVu Ltd. Partnership v. Rex*, [2002] 2 S.C.R. 559 (S.C.C.) at para. 26.

48 More broadly, I believe that the proper approach to the judicial interpretation and application of statutes — particularly those like the CCAA that are skeletal in nature — is succinctly and accurately summarized by Jackson and Sarra in their recent article, *supra*, at p. 56:

> The exercise of a statutory authority requires the statute to be construed. The plain meaning or textualist approach has given way to a search for the object and goals of the statute and the intentionalist approach. This latter approach makes use of the purposive approach and the mischief rule, including its codification under interpretation statutes that every enactment is deemed remedial, and is to be given such fair, large and liberal construction and interpretation as best ensures the attainment of its objects. This latter approach advocates reading the statute as a whole and being mindful of Driedger's "one principle", that the words of the Act are to be read in their entire context, in their grammatical and ordinary sense harmoniously with the scheme of the Act, the object of the Act, and the intention of Parliament. It is important that courts first interpret the statute before them and exercise their authority pursuant to the statute, before reaching for other tools in the judicial toolbox. Statutory interpretation using the principles articulated above leaves room for gap-filling in the common law provinces and a consideration of purpose in *Québec* as a manifestation of the judge's overall task of statutory interpretation. Finally, the jurisprudence in relation to statutory interpretation demonstrates the fluidity inherent in the judge's task in seeking the objects of the statute and the intention of the legislature.

49 I adopt these principles.

50 The remedial purpose of the CCAA — as its title affirms — is to facilitate compromises or arrangements between an insolvent debtor company and its creditors. In *Hongkong Bank of Canada v. Chef Ready Foods Ltd.* (1990), 4 C.B.R. (3d) 311 (B.C. C.A.) at 318, Gibbs J.A. summarized very concisely the purpose, object and scheme of the 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.

51 The CCAA was enacted in 1933 and was necessary — as the then Secretary of State noted in introducing the Bill on First Reading — "because of the prevailing commercial and industrial depression" and the need to alleviate the effects of business bankruptcies in that context: see the statement of the Hon. C.H. Cahan, Secretary of State, *House of Commons Debates (Hansard)* (April 20, 1933) at 4091. One of the greatest effects of that Depression was what Gibbs J.A. described as "the social evil of devastating levels of unemployment". Since then, courts have recognized that the Act has a broader dimension than simply the direct relations between the debtor company and its creditors and that this broader public dimension must be weighed in the balance together with the interests of those most directly affected: see, for example, *Nova Metal Products Inc. v. Comiskey (Trustee of)* (1990), 1 O.R. (3d) 289 (Ont. C.A.), *per* Doherty J.A. in dissent; *Skydome Corp., Re* (1998), 16 C.B.R. (4th) 125 (Ont. Gen. Div. [Commercial List]); *Anvil Range Mining Corp., Re* (1998), 7 C.B.R. (4th) 51 (Ont. Gen. Div. [Commercial List]).

52 In this respect, I agree with the following statement of Doherty J.A. in *Elan*, *supra*, at pp. 306-307:

> . . . [T]he Act was designed to serve a "broad constituency of investors, creditors and employees".[3] Because of that "broad constituency" the court must, when considering applications brought under the Act, *have regard not only to the individuals and organizations directly affected by the application, but also to the wider public interest.* [Emphasis added.]

Application of the Principles of Interpretation

53 An interpretation of the CCAA that recognizes its broader socio-economic purposes and objects is apt in this case. As the application judge pointed out, the restructuring underpins the financial viability of the Canadian ABCP market itself.

54 The appellants argue that the application judge erred in taking this approach and in treating the Plan and the proceedings as an attempt to restructure a financial market (the ABCP market) rather than simply the affairs between the debtor corporations who caused the ABCP Notes to be issued and their creditors. The Act is designed, they say, only to effect reorganizations between a corporate debtor and its creditors and not to attempt to restructure entire marketplaces.

55 This perspective is flawed in at least two respects, however, in my opinion. First, it reflects a view of the purpose and objects of the CCAA that is too narrow. Secondly, it overlooks the reality of the ABCP marketplace and the context of the restructuring in question here. It may be true that, in their capacity as ABCP *Dealers*, the releasee financial institutions are "third-parties" to the restructuring in the sense that they are not creditors of the debtor corporations. However, in their capacities as *Asset Providers* and *Liquidity Providers*, they are not only creditors but they are prior secured creditors to the Noteholders. Furthermore — as the application judge found — in these latter capacities they are making significant contributions to the restructuring by "foregoing immediate rights to assets and ... providing real and tangible input for the preservation and enhancement of the Notes" (para. 76). In this context, therefore, the application judge's remark at para. 50 that the restructuring "involves the commitment and participation of all parties" in the ABCP market makes sense, as do his earlier comments at paras. 48-49:

> Given the nature of the ABCP market and all of its participants, it is more appropriate to consider all Noteholders as claimants and the object of the Plan to restore liquidity to the assets being the Notes themselves. The restoration of the liquidity of the market necessitates the participation (including more tangible contribution by many) of all Noteholders.
>
> In these circumstances, *it is unduly technical to classify the Issuer Trustees as debtors and the claims of the Noteholders as between themselves and others as being those of third party creditors*, although I recognize that the restructuring structure of the CCAA requires the corporations as the vehicles for restructuring. [Emphasis added.]

56 The application judge did observe that "[t]he insolvency is of the ABCP market itself, the restructuring is that of the market for such paper ..." (para. 50). He did so, however, to point out the uniqueness of the Plan before him and its industry-wide significance and not to suggest that he need have no regard to the provisions of the CCAA permitting a restructuring as between debtor and creditors. His focus was on *the effect* of the restructuring, a perfectly permissible perspective, given the broad purpose and objects of the Act. This is apparent from his later references. For example, in balancing the arguments against approving releases that might include aspects of fraud, he responded that "what is at issue is a liquidity crisis that affects the ABCP market in Canada" (para. 125). In addition, in his reasoning on the fair-and-reasonable issue, he stated at para. 142: "Apart from the Plan itself, there is a need to restore confidence in the financial system in Canada and this Plan is a legitimate use of the CCAA to accomplish that goal."

57 I agree. I see no error on the part of the application judge in approaching the fairness assessment or the interpretation issue with these considerations in mind. They provide the context in which the purpose, objects and scheme of the CCAA are to be considered.

The Statutory Wording

58 Keeping in mind the interpretive principles outlined above, I turn now to a consideration of the provisions of the CCAA. Where in the words of the statute is the court clothed with authority to approve a plan incorporating a requirement for third-party releases? As summarized earlier, the answer to that question, in my view, is to be found in:

> a) the skeletal nature of the CCAA;
>
> b) Parliament's reliance upon the broad notions of "compromise" and "arrangement" to establish the framework within which the parties may work to put forward a restructuring plan; and in
>
> c) the creation of the statutory mechanism binding all creditors in classes to the compromise or arrangement once it has surpassed the high "double majority" voting threshold and obtained court sanction as "fair and reasonable".

Therein lies the expression of Parliament's intention to permit the parties to negotiate and vote on, and the court to sanction, third-party releases relating to a restructuring.

59 Sections 4 and 6 of the CCAA state:

> 4. Where a compromise or an arrangement is proposed between a debtor company and its unsecured creditors or any class of them, the court may, on the application in a summary way of the company, of any such creditor or of the trustee in bankruptcy or liquidator of the company, order a meeting of the creditors or class of creditors, and, if the court so determines, of the shareholders of the company, to be summoned in such manner as the court directs.
>
> 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 bankruptcy 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.

Compromise or Arrangement

60 While there may be little practical distinction between "compromise" and "arrangement" in many respects, the two are not necessarily the same. "Arrangement" is broader than "compromise" and would appear to include any scheme for reorganizing the affairs of the debtor: Houlden & Morawetz, *Bankruptcy and Insolvency Law of Canada*, loose-leaf, 3rd ed., vol. 4 (Toronto: Thomson Carswell) at 10A-12.2, N§10. It has been said to be "a very wide and indefinite [word]": *Reference re Refund of Dues Paid under s.47 (f) of Timber Regulations in the Western Provinces*, [1935] A.C. 184 (Canada P.C.) at 197, affirming S.C.C. [1933] S.C.R. 616 (S.C.C.). See also, *Guardian Assurance Co., Re*, [1917] 1 Ch. 431 (Eng. C.A.) at 448, 450; *T&N Ltd., Re* (2006), [2007] 1 All E.R. 851 (Eng. Ch. Div.).

61 The CCAA is a sketch, an outline, a supporting framework for the resolution of corporate insolvencies in the public interest. Parliament wisely avoided attempting to anticipate the myriad of business deals that could evolve from the fertile and creative minds of negotiators restructuring their financial affairs. It left the shape and details of those deals to be worked out within the framework of the comprehensive and flexible concepts of a "compromise" and "arrangement." I see no reason why a release in favour of a third party, negotiated as part of a package between a debtor and creditor and reasonably relating to the proposed restructuring cannot fall within that framework.

62 A proposal under the *Bankruptcy and Insolvency Act*, R.S., 1985, c. B-3 (the "BIA") is a contract: *Employers' Liability Assurance Corp. v. Ideal Petroleum (1959) Ltd.*, [1978] 1 S.C.R. 230 (S.C.C.) at 239; *Society of Composers, Authors & Music Publishers of Canada v. Armitage* (2000), 50 O.R. (3d) 688 (Ont. C.A.) at para. 11. In my view, a compromise or arrangement under the CCAA is directly analogous to a proposal for these purposes, and therefore is to be treated as a contract between the debtor and its creditors. Consequently, parties are entitled to put anything into such a plan that could lawfully be incorporated into any contract. See *Air Canada, Re* (2004), 2 C.B.R. (5th) 4 (Ont. S.C.J. [Commercial List]) at para. 6; *Olympia & York Developments Ltd. v. Royal Trust Co.* (1993), 12 O.R. (3d) 500 (Ont. Gen. Div.) at 518.

63 There is nothing to prevent a debtor and a creditor from including in a contract between them a term providing that the creditor release a third party. The term is binding as between the debtor and creditor. In the CCAA context, therefore, a plan of compromise or arrangement may propose that creditors agree to compromise claims against the debtor and to release third parties, just as any debtor and creditor might agree to such a term in a contract between them. Once the statutory mechanism regarding voter approval and court sanctioning has been complied with, the plan — including the provision for releases — becomes binding on all creditors (including the dissenting minority).

64 *T&N Ltd., Re, supra*, is instructive in this regard. It is a rare example of a court focussing on and examining the meaning and breadth of the term "arrangement". T&N and its associated companies were engaged in the manufacture, distribution and sale of asbestos-containing products. They became the subject of many claims by former employees, who had been exposed to asbestos dust in the course of their employment, and their dependents. The T&N companies applied for protection under s. 425 of the U.K. *Companies Act 1985*, a provision virtually identical to the scheme of the CCAA — including the concepts of compromise or arrangement. [4]

65 T&N carried employers' liability insurance. However, the employers' liability insurers (the "EL insurers") denied coverage. This issue was litigated and ultimately resolved through the establishment of a multi-million pound fund

against which the employees and their dependants (the "EL claimants") would assert their claims. In return, T&N's former employees and dependants (the "EL claimants") agreed to forego any further claims against the EL insurers. This settlement was incorporated into the plan of compromise and arrangement between the T&N companies and the EL claimants that was voted on and put forward for court sanction.

66 Certain creditors argued that the court could not sanction the plan because it did not constitute a "compromise or arrangement" between T&N and the EL claimants since it did not purport to affect rights as between them but only the EL claimants' rights against the EL insurers. The Court rejected this argument. Richards J. adopted previous jurisprudence — cited earlier in these reasons — to the effect that the word "arrangement" has a very broad meaning and that, while both a compromise and an arrangement involve some "give and take", an arrangement need not involve a compromise or be confined to a case of dispute or difficulty (paras. 46-51). He referred to what would be the equivalent of a solvent arrangement under Canadian corporate legislation as an example. [5] Finally, he pointed out that the compromised rights of the EL claimants against the EL insurers were not unconnected with the EL claimants' rights against the T&N companies; the scheme of arrangement involving the EL insurers was "an integral part of a single proposal affecting all the parties" (para. 52). He concluded his reasoning with these observations (para. 53):

> In my judgment it is not a necessary element of an arrangement for the purposes of s 425 of the 1985 Act that it should alter the rights existing between the company and the creditors or members with whom it is made. No doubt in most cases it will alter those rights. But, provided that the context and content of the scheme are such as properly to constitute an arrangement between the company and the members or creditors concerned, it will fall within s 425. It is ... neither necessary nor desirable to attempt a definition of arrangement. The legislature has not done so. To insist on an alteration of rights, or a termination of rights as in the case of schemes to effect takeovers or mergers, is to impose a restriction which is neither warranted by the statutory language nor justified by the courts' approach over many years to give the term its widest meaning. *Nor is an arrangement necessarily outside the section, because its effect is to alter the rights of creditors against another party or because such alteration could be achieved by a scheme of arrangement with that party.* [Emphasis added.]

67 I find Richard J.'s analysis helpful and persuasive. In effect, the claimants in *T&N* were being asked to release their claims against the EL insurers in exchange for a call on the fund. Here, the appellants are being required to release their claims against certain financial third parties in exchange for what is anticipated to be an improved position for all ABCP Noteholders, stemming from the contributions the financial third parties are making to the ABCP restructuring. The situations are quite comparable.

The Binding Mechanism

68 Parliament's reliance on the expansive terms "compromise" or "arrangement" does not stand alone, however. Effective insolvency restructurings would not be possible without a statutory mechanism to bind an unwilling minority of creditors. Unanimity is frequently impossible in such situations. But the minority must be protected too. Parliament's solution to this quandary was to permit a wide range of proposals to be negotiated and put forward (the compromise or arrangement) and to bind *all* creditors by class to the terms of the plan, but to do so only where the proposal can gain the support of the requisite "double majority" of votes [6] *and* obtain the sanction of the court on the basis that it is fair and reasonable. In this way, the scheme of the CCAA supports the intention of Parliament to encourage a wide variety of solutions to corporate insolvencies without unjustifiably overriding the rights of dissenting creditors.

The Required Nexus

69 In keeping with this scheme and purpose, I do not suggest that any and all releases between creditors of the debtor company seeking to restructure and third parties may be made the subject of a compromise or arrangement between the debtor and its creditors. Nor do I think the fact that the releases may be "necessary" in the sense that the third parties or the debtor may refuse to proceed without them, of itself, advances the argument in favour of finding jurisdiction (although it may well be relevant in terms of the fairness and reasonableness analysis).

70 The release of the claim in question must be justified as part of the compromise or arrangement between the debtor and its creditors. In short, there must be a reasonable connection between the third party claim being compromised in the plan and the restructuring achieved by the plan to warrant inclusion of the third party release in the plan. This nexus exists here, in my view.

71 In the course of his reasons, the application judge made the following findings, all of which are amply supported on the record:

> a) The parties to be released are necessary and essential to the restructuring of the debtor;
>
> b) *The claims to be released are rationally related to the purpose of the Plan and necessary for it*;
>
> c) The Plan cannot succeed without the releases;
>
> d) *The parties who are to have claims against them released are contributing in a tangible and realistic way to the Plan*; and
>
> e) The Plan will benefit not only the debtor companies but creditor Noteholders generally.

72 Here, then — as was the case in *T&N* — there is a close connection between the claims being released and the restructuring proposal. The tort claims arise out of the sale and distribution of the ABCP Notes and their collapse in value, just as do the contractual claims of the creditors against the debtor companies. The purpose of the restructuring is to stabilize and shore up the value of those notes in the long run. The third parties being released are making separate contributions to enable those results to materialize. Those contributions are identified earlier, at para. 31 of these reasons. The application judge found that the claims being released are not independent of or unrelated to the claims that the Noteholders have against the debtor companies; they are closely connected to the value of the ABCP Notes and are required for the Plan to succeed. At paras. 76-77 he said:

> [76] I do not consider that the Plan in this case involves a change in relationship among creditors "that does not directly involve the Company." Those who support the Plan and are to be released are "directly involved in the Company" in the sense that many are foregoing immediate rights to assets and are providing real and tangible input for the preservation and enhancement of the Notes. It would be unduly restrictive to suggest that the moving parties' claims against released parties do not involve the Company, since the claims are directly related to the value of the Notes. The value of the Notes is in this case the value of the Company.
>
> [77] This Plan, as it deals with releases, doesn't change the relationship of the creditors apart from involving the Company and its Notes.

73 I am satisfied that the wording of the CCAA — construed in light of the purpose, objects and scheme of the Act and in accordance with the modern principles of statutory interpretation — supports the court's jurisdiction and authority to sanction the Plan proposed here, including the contested third-party releases contained in it.

The Jurisprudence

74 Third party releases have become a frequent feature in Canadian restructurings since the decision of the Alberta Court of Queen's Bench in *Canadian Airlines Corp., Re* (2000), 265 A.R. 201 (Alta. Q.B.), leave to appeal refused by (2000), 266 A.R. 131 (Alta. C.A. [In Chambers]), and (2001), 293 A.R. 351 (note) (S.C.C.). In *Muscletech Research & Development Inc., Re* (2006), 25 C.B.R. (5th) 231 (Ont. S.C.J.) Justice Ground remarked (para. 8):

> [It] is not uncommon in CCAA proceedings, in the context of a plan of compromise and arrangement, to compromise claims against the Applicants and other parties against whom such claims or related claims are made.

75 We were referred to at least a dozen court-approved CCAA plans from across the country that included broad third-party releases. With the exception of *Canadian Airlines Corp., Re*, however, the releases in those restructurings — including *Muscletech Research & Development Inc., Re* — were not opposed. The appellants argue that those cases are wrongly decided, because the court simply does not have the authority to approve such releases.

76 In *Canadian Airlines Corp., Re* the releases in question were opposed, however. Paperny J. (as she then was) concluded the court had jurisdiction to approve them and her decision is said to be the well-spring of the trend towards third-party releases referred to above. Based on the foregoing analysis, I agree with her conclusion although for reasons that differ from those cited by her.

77 Justice Paperny began her analysis of the release issue with the observation at para. 87 that "[p]rior to 1997, the CCAA did not provide for compromises of claims against anyone other than the petitioning company." It will be apparent from the analysis in these reasons that I do not accept that premise, notwithstanding the decision of the Quebec Court of Appeal in *Steinberg Inc. c. Michaud*,[7] of which her comment may have been reflective. Paperny J.'s reference to 1997 was a reference to the amendments of that year adding s. 5.1 to the CCAA, which provides for limited releases in favour of directors. Given the limited scope of s. 5.1, Justice Paperny was thus faced with the argument — dealt with later in these reasons — that Parliament must not have intended to extend the authority to approve third-party releases beyond the scope of this section. She chose to address this contention by concluding that, although the amendments "[did] not authorize a release of claims against third parties other than directors, [they did] not prohibit such releases either" (para. 92).

78 Respectfully, I would not adopt the interpretive principle that the CCAA permits releases because it does not expressly prohibit them. Rather, as I explain in these reasons, I believe the open-ended CCAA permits third-party releases that are reasonably related to the restructuring at issue because they are encompassed in the comprehensive terms "compromise" and "arrangement" and because of the double-voting majority and court sanctioning statutory mechanism that makes them binding on unwilling creditors.

79 The appellants rely on a number of authorities, which they submit support the proposition that the CCAA may not be used to compromise claims as between anyone other than the debtor company and its creditors. Principal amongst these are *Steinberg Inc. c. Michaud, supra*; *NBD Bank, Canada v. Dofasco Inc.* (1999), 46 O.R. (3d) 514 (Ont. C.A.); *Pacific Coastal Airlines Ltd. v. Air Canada* (2001), 19 B.L.R. (3d) 286 (B.C. S.C.); and *Stelco Inc., Re* (2005), 78 O.R. (3d) 241 (Ont. C.A.) ("*Stelco I*"). I do not think these cases assist the appellants, however. With the exception of *Steinberg Inc.*, they do not involve third party claims that were reasonably connected to the restructuring. As I shall explain, it is my opinion that *Steinberg Inc.* does not express a correct view of the law, and I decline to follow it.

80 In *Pacific Coastal Airlines Ltd.*, Tysoe J. made the following comment at para. 24:

> [The purpose of the CCAA proceeding] is not to deal with disputes between a creditor of a company and a third party, even if the company was also involved in the subject matter of the dispute. While issues between the debtor company and non-creditors are sometimes dealt with in CCAA proceedings, it is not a proper use of a CCAA proceeding to determine disputes between parties other than the debtor company.

81 This statement must be understood in its context, however. Pacific Coastal Airlines had been a regional carrier for Canadian Airlines prior to the CCAA reorganization of the latter in 2000. In the action in question it was seeking to assert separate tort claims against Air Canada for contractual interference and inducing breach of contract in relation to certain rights it had to the use of Canadian's flight designator code prior to the CCAA proceeding. Air Canada sought to have the action dismissed on grounds of *res judicata* or issue estoppel because of the CCAA proceeding. Tysoe J. rejected the argument.

82 The facts in *Pacific Coastal Airlines Ltd.* are not analogous to the circumstances of this case, however. There is no suggestion that a resolution of Pacific Coastal's separate tort claim against Air Canada was in any way connected to the Canadian Airlines restructuring, even though Canadian — at a contractual level — may have had some involvement with the particular dispute. Here, however, the disputes that are the subject-matter of the impugned releases are not simply "disputes between parties other than the debtor company". They are closely connected to the disputes being resolved between the debtor companies and their creditors and to the restructuring itself.

83 Nor is the decision of this Court in the *NBD Bank, Canada* case dispositive. It arose out of the financial collapse of Algoma Steel, a wholly-owned subsidiary of Dofasco. The Bank had advanced funds to Algoma allegedly on the strength of misrepresentations by Algoma's Vice-President, James Melville. The plan of compromise and arrangement that was sanctioned by Farley J. in the Algoma CCAA restructuring contained a clause releasing Algoma from all claims creditors "may have had against Algoma or its directors, officers, employees and advisors." Mr. Melville was found liable for negligent misrepresentation in a subsequent action by the Bank. On appeal, he argued that since the Bank was barred from suing Algoma for misrepresentation by its officers, permitting it to pursue the same cause of action against him personally would subvert the CCAA process — in short, he was personally protected by the CCAA release.

84 Rosenberg J.A., writing for this Court, rejected this argument. The appellants here rely particularly upon his following observations at paras. 53-54:

> 53 In my view, the appellant has not demonstrated that allowing the respondent to pursue its claim against him would undermine or subvert the purposes of the Act. As this court noted in *Elan Corp. v. Comiskey* (1990), 1 O.R. (3d) 289 at 297, the *CCAA* is remedial legislation "intended to provide a structured environment for the negotiation of compromises between a debtor company and its creditors for the benefit of both". It is a means of avoiding a liquidation that may yield little for the creditors, especially unsecured creditors like the respondent, and the debtor company shareholders. However, the appellant has not shown that allowing a creditor to continue an action against an officer for negligent misrepresentation would erode the effectiveness of the Act.
>
> 54 In fact, to refuse on policy grounds to impose liability on an officer of the corporation for negligent misrepresentation would contradict the policy of Parliament as demonstrated in recent amendments to the *CCAA* and the *Bankruptcy and Insolvency Act*, R.S.C. 1985, c. B-3. Those Acts now contemplate that an arrangement or proposal may include a term for compromise of certain types of claims against directors of the company except claims that "are based on allegations of misrepresentations made by directors". L.W. Houlden and C.H. Morawetz, the editors of *The 2000 Annotated Bankruptcy and Insolvency Act* (Toronto: Carswell, 1999) at p. 192 are of the view that the policy behind the provision is to encourage directors of an insolvent corporation to remain in office so that the affairs of the corporation can be reorganized. I can see no similar policy interest in barring an action against an officer of the company who, prior to the insolvency, has misrepresented the financial affairs of the corporation to its creditors. It may be necessary to permit the compromise of claims against the debtor corporation, otherwise it may not be possible to successfully reorganize the corporation. The same considerations do not apply to individual officers. Rather, it would seem to me that it would be contrary to good policy to immunize officers from the consequences of their negligent statements which might otherwise be made in anticipation of being forgiven under a subsequent corporate proposal or arrangement. [Footnote omitted.]

85 Once again, this statement must be assessed in context. Whether Justice Farley had the authority in the earlier Algoma CCAA proceedings to sanction a plan that included third party releases was not under consideration at all. What the Court was determining in *NBD Bank, Canada* was whether the release extended by its terms to protect a third party. In fact, on its face, it does not appear to do so. Justice Rosenberg concluded only that not allowing Mr. Melville to rely upon the release did not subvert the purpose of the CCAA. As the application judge here observed, "there is little factual similarity in *NBD Bank, Canada* to the facts now before the Court" (para. 71). Contrary to the facts of this case, in *NBD Bank, Canada* the creditors had not agreed to grant a release to officers; they had not voted on such a release and the court had not assessed the fairness and reasonableness of such a release as a term of a complex arrangement

involving significant contributions by the beneficiaries of the release — as is the situation here. Thus, *NBD Bank, Canada* is of little assistance in determining whether the court has authority to sanction a plan that calls for third party releases.

86 The appellants also rely upon the decision of this Court in *Stelco I.* There, the Court was dealing with the scope of the CCAA in connection with a dispute over what were called the "Turnover Payments". Under an inter-creditor agreement one group of creditors had subordinated their rights to another group and agreed to hold in trust and "turn over" any proceeds received from Stelco until the senior group was paid in full. On a disputed classification motion, the Subordinated Debt Holders argued that they should be in a separate class from the Senior Debt Holders. Farley J. refused to make such an order in the court below, stating:

> [Sections] 4, 5 and 6 [of the CCAA] talk of compromises or arrangements between a company and its creditors. There is no mention of this extending by statute to encompass a change of relationship among the creditors vis-à-vis the creditors themselves *and not directly involving the company.* [Citations omitted; emphasis added.]

See *Re Stelco Inc.* (2005), 15 C.B.R. (5th) 297 (Ont. S.C.J. [Commercial List]) at para. 7.

87 This Court upheld that decision. The legal relationship between each group of creditors and Stelco was the same, albeit there were inter-creditor differences, and creditors were to be classified in accordance with their legal rights. In addition, the need for timely classification and voting decisions in the CCAA process militated against enmeshing the classification process in the vagaries of inter-corporate disputes. In short, the issues before the Court were quite different from those raised on this appeal.

88 Indeed, the Stelco plan, as sanctioned, included third party releases (albeit uncontested ones). This Court subsequently dealt with the same inter-creditor agreement on an appeal where the Subordinated Debt Holders argued that the inter-creditor subordination provisions were beyond the reach of the CCAA and therefore that they were entitled to a separate civil action to determine their rights under the agreement: *Stelco Inc., Re* (2006), 21 C.B.R. (5th) 157 (Ont. C.A.) (*"Stelco II"*). The Court rejected that argument and held that where the creditors' rights amongst themselves were sufficiently related to the debtor and its plan, they were properly brought within the scope of the CCAA plan. The Court said (para. 11):

> In [*Stelco I*] — the classification case — the court observed that it is not a proper use of a CCAA proceeding to determine disputes between parties other than the debtor company ... [*H*]*owever, the present case is not simply an inter-creditor dispute that does not involve the debtor company; it is a dispute that is inextricably connected to the restructuring process.* [Emphasis added.]

89 The approach I would take to the disposition of this appeal is consistent with that view. As I have noted, the third party releases here are very closely connected to the ABCP restructuring process.

90 Some of the appellants — particularly those represented by Mr. Woods — rely heavily upon the decision of the Quebec Court of Appeal in *Steinberg Inc. c. Michaud, supra.* They say that it is determinative of the release issue. In *Steinberg*, the Court held that the CCAA, as worded at the time, did not permit the release of directors of the debtor corporation and that third-party releases were not within the purview of the Act. Deschamps J.A. (as she then was) said (paras. 42, 54 and 58 — English translation):

> [42] Even if one can understand the extreme pressure weighing on the creditors and the respondent at the time of the sanctioning, a plan of arrangement is not the appropriate forum to settle disputes other than the claims that are the subject of the arrangement. In other words, one cannot, under the pretext of an absence of formal directives in the Act, transform an arrangement into a potpourri.
>
> . . . . .
>
> [54] The Act offers the respondent a way to arrive at a compromise with is creditors. It does not go so far as to offer an umbrella to all the persons within its orbit by permitting them to shelter themselves from any recourse.

. . . . .

> [58] The [CCAA] and the case law clearly do not permit extending the application of an arrangement to persons other than the respondent and its creditors and, consequently, the plan should not have been sanctioned as is [that is, including the releases of the directors].

91 Justices Vallerand and Delisle, in separate judgments, agreed. Justice Vallerand summarized his view of the consequences of extending the scope of the CCAA to third party releases in this fashion (para. 7):

> In short, the Act will have become the Companies' *and Their Officers and Employees* Creditors Arrangement Act — an awful mess — and likely not attain its purpose, which is to enable the company to survive in the face of *its* creditors and through their will, and not in the face of the creditors of its officers. This is why I feel, just like my colleague, that such a clause is contrary to the Act's mode of operation, contrary to its purposes and, for this reason, is to be banned.

92 Justice Delisle, on the other hand, appears to have rejected the releases because of their broad nature — they released directors from all claims, including those that were altogether unrelated to their corporate duties with the debtor company — rather than because of a lack of authority to sanction under the Act. Indeed, he seems to have recognized the wide range of circumstances that could be included within the term "compromise or arrangement". He is the only one who addressed that term. At para. 90 he said:

> The CCAA is drafted in general terms. It does not specify, among other things, what must be understood by "compromise or arrangement". However, it may be inferred from the purpose of this [A]ct that these terms *encompass all that should enable the person who has recourse to it to fully dispose of his debts*, both those that exist on the date when he has recourse to the statute and *those contingent on the insolvency in which he finds himself* ... [Emphasis added.]

93 The decision of the Court did not reflect a view that the terms of a compromise or arrangement should "encompass all that should enable the person who has recourse to [the Act] to dispose of his debts ... and those contingent on the insolvency in which he finds himself," however. On occasion such an outlook might embrace third parties other than the debtor and its creditors in order to make the arrangement work. Nor would it be surprising that, in such circumstances, the third parties might seek the protection of releases, or that the debtor might do so on their behalf. Thus, the perspective adopted by the majority in *Steinberg Inc.*, in my view, is too narrow, having regard to the language, purpose and objects of the CCAA and the intention of Parliament. They made no attempt to consider and explain why a compromise or arrangement could not include third-party releases. In addition, the decision appears to have been based, at least partly, on a rejection of the use of contract-law concepts in analysing the Act — an approach inconsistent with the jurisprudence referred to above.

94 Finally, the majority in *Steinberg Inc.* seems to have proceeded on the basis that the CCAA cannot interfere with civil or property rights under Quebec law. Mr. Woods advanced this argument before this Court in his factum, but did not press it in oral argument. Indeed, he conceded that if the Act encompasses the authority to sanction a plan containing third-party releases — as I have concluded it does — the provisions of the CCAA, as valid federal insolvency legislation, are paramount over provincial legislation. I shall return to the constitutional issues raised by the appellants later in these reasons.

95 Accordingly, to the extent *Steinberg Inc.* stands for the proposition that the court does not have authority under the CCAA to sanction a plan that incorporates third-party releases, I do not believe it to be a correct statement of the law and I respectfully decline to follow it. The modern approach to interpretation of the Act in accordance with its nature and purpose militates against a narrow interpretation and towards one that facilitates and encourages compromises and arrangements. Had the majority in *Steinberg Inc.* considered the broad nature of the terms "compromise" and "arrangement" and the jurisprudence I have referred to above, they might well have come to a different conclusion.

The 1997 Amendments

96 *Steinberg Inc.* led to amendments to the CCAA, however. In 1997, s. 5.1 was added, dealing specifically with releases pertaining to directors of the debtor company. It 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 that 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.
>
> **Exception**
>
> (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.
>
> **Powers of court**
>
> (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.
>
> **Resignation or removal of directors**
>
> (4) Where all of the directors have resigned or have been removed by the shareholders without replacement, any person who manages or supervises the management of the business and affairs of the debtor company shall be deemed to be a director for the purposes of this section.
>
> 1997, c. 12, s. 122.

97 Perhaps the appellants' strongest argument is that these amendments confirm a prior lack of authority in the court to sanction a plan including third party releases. If the power existed, why would Parliament feel it necessary to add an amendment specifically permitting such releases (subject to the exceptions indicated) in favour of directors? *Expressio unius est exclusio alterius*, is the Latin maxim sometimes relied on to articulate the principle of interpretation implied in that question: to express or include one thing implies the exclusion of the other.

98 The maxim is not helpful in these circumstances, however. The reality is that there *may* be another explanation why Parliament acted as it did. As one commentator has noted: [8]

> Far from being a rule, [the maxim *expressio unius*] is not even lexicographically accurate, because it is simply not true, generally, that the mere express conferral of a right or privilege in one kind of situation implies the denial of the equivalent right or privilege in other kinds. Sometimes it does and sometimes its does not, and whether it does or does not depends on the particular circumstances of context. Without contextual support, therefore there is not even a mild presumption here. Accordingly, the maxim is at best a description, after the fact, of what the court has discovered from context.

99 As I have said, the 1997 amendments to the CCAA providing for releases in favour of directors of debtor companies in limited circumstances were a response to the decision of the Quebec Court of Appeal in *Steinberg Inc.*. A similar amendment was made with respect to proposals in the BIA at the same time. The rationale behind these amendments was to encourage directors of an insolvent company to remain in office during a restructuring, rather than resign. The

assumption was that by remaining in office the directors would provide some stability while the affairs of the company were being reorganized: see Houlden & Morawetz, vol.1, *supra*, at 2-144, E§11A; *Royal Penfield Inc., Re*, [2003] R.J.Q. 2157 (C.S. Que.) at paras. 44-46.

100 Parliament thus had a particular focus and a particular purpose in enacting the 1997 amendments to the CCAA and the BIA. While there is some merit in the appellants' argument on this point, at the end of the day I do not accept that Parliament intended to signal by its enactment of s. 5.1 that it was depriving the court of authority to sanction plans of compromise or arrangement in all circumstances where they incorporate third party releases in favour of anyone other than the debtor's directors. For the reasons articulated above, I am satisfied that the court does have the authority to do so. Whether it sanctions the plan is a matter for the fairness hearing.

The Deprivation of Proprietary Rights

101 Mr. Shapray very effectively led the appellants' argument that legislation must not be construed so as to interfere with or prejudice established contractual or proprietary rights — including the right to bring an action — in the absence of a clear indication of legislative intention to that effect: *Halsbury's Laws of England*, 4th ed. reissue, vol. 44 (1) (London: Butterworths, 1995) at paras. 1438, 1464 and 1467; Driedger, 2nd ed., *supra*, at 183; Ruth Sullivan, *Sullivan and Driedger on the Construction of Statutes*, 4th ed., (Markham: Butterworths, 2002) at 399. I accept the importance of this principle. For the reasons I have explained, however, I am satisfied that Parliament's intention to clothe the court with authority to consider and sanction a plan that contains third party releases is expressed with sufficient clarity in the "compromise or arrangement" language of the CCAA coupled with the statutory voting and sanctioning mechanism making the provisions of the plan binding on all creditors. This is not a situation of impermissible "gap-filling" in the case of legislation severely affecting property rights; it is a question of finding meaning in the language of the Act itself. I would therefore not give effect to the appellants' submissions in this regard.

The Division of Powers and Paramountcy

102 Mr. Woods and Mr. Sternberg submit that extending the reach of the CCAA process to the compromise of claims as between solvent creditors of the debtor company and solvent third parties to the proceeding is constitutionally impermissible. They say that under the guise of the federal insolvency power pursuant to s. 91(21) of the *Constitution Act, 1867*, this approach would improperly affect the rights of civil claimants to assert their causes of action, a provincial matter falling within s. 92(13), and contravene the rules of public order pursuant to the *Civil Code of Quebec*.

103 I do not accept these submissions. It has long been established that the CCAA is valid federal legislation under the federal insolvency power: *Reference re Companies' Creditors Arrangement Act (Canada)*, [1934] S.C.R. 659 (S.C.C.). As the Supreme Court confirmed in that case (p. 661), citing Viscount Cave L.C. in *Quebec (Attorney General) v. Bélanger (Trustee of)*, [1928] A.C. 187 (Canada P.C.), "the exclusive legislative authority to deal with all matters within the domain of bankruptcy and insolvency is vested in Parliament." Chief Justice Duff elaborated:

> Matters normally constituting part of a bankruptcy scheme but not in their essence matters of bankruptcy and insolvency may, of course, from another point of view and in another aspect be dealt with by a provincial legislature; but, when treated as matters pertaining to bankruptcy and insolvency, they clearly fall within the legislative authority of the Dominion.

104 That is exactly the case here. The power to sanction a plan of compromise or arrangement that contains third-party releases of the type opposed by the appellants is embedded in the wording of the CCAA. The fact that this may interfere with a claimant's right to pursue a civil action — normally a matter of provincial concern — or trump Quebec rules of public order is constitutionally immaterial. The CCAA is a valid exercise of federal power. Provided the matter in question falls within the legislation directly or as necessarily incidental to the exercise of that power, the CCAA governs. To the extent that its provisions are inconsistent with provincial legislation, the federal legislation is paramount. Mr. Woods properly conceded this during argument.

Conclusion With Respect to Legal Authority

105 For all of the foregoing reasons, then, I conclude that the application judge had the jurisdiction and legal authority to sanction the Plan as put forward.

(2) The Plan is "Fair and Reasonable"

106 The second major attack on the application judge's decision is that he erred in finding that the Plan is "fair and reasonable" and in sanctioning it on that basis. This attack is centred on the nature of the third-party releases contemplated and, in particular, on the fact that they will permit the release of some claims based in fraud.

107 Whether a plan of compromise or arrangement is fair and reasonable is a matter of mixed fact and law, and one on which the application judge exercises a large measure of discretion. The standard of review on this issue is therefore one of deference. In the absence of a demonstrable error an appellate court will not interfere: see *Ravelston Corp., Re* (2007), 31 C.B.R. (5th) 233 (Ont. C.A. [In Chambers]).

108 I would not interfere with the application judge's decision in this regard. While the notion of releases in favour of third parties — including leading Canadian financial institutions — that extend to claims of fraud is distasteful, there is no legal impediment to the inclusion of a release for claims based in fraud in a plan of compromise or arrangement. The application judge had been living with and supervising the ABCP restructuring from its outset. He was intimately attuned to its dynamics. In the end he concluded that the benefits of the Plan to the creditors as a whole, and to the debtor companies, outweighed the negative aspects of compelling the unwilling appellants to execute the releases as finally put forward.

109 The application judge was concerned about the inclusion of fraud in the contemplated releases and at the May hearing adjourned the final disposition of the sanctioning hearing in an effort to encourage the parties to negotiate a resolution. The result was the "fraud carve-out" referred to earlier in these reasons.

110 The appellants argue that the fraud carve-out is inadequate because of its narrow scope. It (i) applies only to ABCP Dealers, (ii) limits the type of damages that may be claimed (no punitive damages, for example), (iii) defines "fraud" narrowly, excluding many rights that would be protected by common law, equity and the Quebec concept of public order, and (iv) limits claims to representations made directly to Noteholders. The appellants submit it is contrary to public policy to sanction a plan containing such a limited restriction on the type of fraud claims that may be pursued against the third parties.

111 The law does not condone fraud. It is the most serious kind of civil claim. There is therefore some force to the appellants' submission. On the other hand, as noted, there is no legal impediment to granting the release of an antecedent claim in fraud, provided the claim is in the contemplation of the parties to the release at the time it is given: *Fotinis Restaurant Corp. v. White Spot Ltd* (1998), 38 B.L.R. (2d) 251 (B.C. S.C. [In Chambers]) at paras. 9 and 18. There may be disputes about the scope or extent of what is released, but parties are entitled to settle allegations of fraud in civil proceedings — the claims here all being untested allegations of fraud — and to include releases of such claims as part of that settlement.

112 The application judge was alive to the merits of the appellants' submissions. He was satisfied in the end, however, that the need "to avoid the potential cascade of litigation that ... would result if a broader 'carve out' were to be allowed" (para. 113) outweighed the negative aspects of approving releases with the narrower carve-out provision. Implementation of the Plan, in his view, would work to the overall greater benefit of the Noteholders as a whole. I can find no error in principle in the exercise of his discretion in arriving at this decision. It was his call to make.

113 At para. 71 above I recited a number of factual findings the application judge made in concluding that approval of the Plan was within his jurisdiction under the CCAA and that it was fair and reasonable. For convenience, I reiterate

them here — with two additional findings — because they provide an important foundation for his analysis concerning the fairness and reasonableness of the Plan. The application judge found that:

> a) The parties to be released are necessary and essential to the restructuring of the debtor;
>
> b) The claims to be released are rationally related to the purpose of the Plan and necessary for it;
>
> c) The Plan cannot succeed without the releases;
>
> d) The parties who are to have claims against them released are contributing in a tangible and realistic way to the Plan;
>
> e) The Plan will benefit not only the debtor companies but creditor Noteholders generally;
>
> f) The voting creditors who have approved the Plan did so with knowledge of the nature and effect of the releases; and that,
>
> g) The releases are fair and reasonable and not overly broad or offensive to public policy.

114 These findings are all supported on the record. Contrary to the submission of some of the appellants, they do not constitute a new and hitherto untried "test" for the sanctioning of a plan under the CCAA. They simply represent findings of fact and inferences on the part of the application judge that underpin his conclusions on jurisdiction and fairness.

115 The appellants all contend that the obligation to release the third parties from claims in fraud, tort, breach of fiduciary duty, etc. is confiscatory and amounts to a requirement that they — as individual creditors — make the equivalent of a greater financial contribution to the Plan. In his usual lively fashion, Mr. Sternberg asked us the same rhetorical question he posed to the application judge. As he put it, how could the court countenance the compromise of what in the future might turn out to be fraud perpetrated at the highest levels of Canadian and foreign banks? Several appellants complain that the proposed Plan is unfair to them because they will make very little additional recovery if the Plan goes forward, but will be required to forfeit a cause of action against third-party financial institutions that may yield them significant recovery. Others protest that they are being treated unequally because they are ineligible for relief programs that Liquidity Providers such as Canaccord have made available to other smaller investors.

116 All of these arguments are persuasive to varying degrees when considered in isolation. The application judge did not have that luxury, however. He was required to consider the circumstances of the restructuring as a whole, including the reality that many of the financial institutions were not only acting as Dealers or brokers of the ABCP Notes (with the impugned releases relating to the financial institutions in these capacities, for the most part) but also as Asset and Liquidity Providers (with the financial institutions making significant contributions to the restructuring in these capacities).

117 In insolvency restructuring proceedings almost everyone loses something. To the extent that creditors are required to compromise their claims, it can always be proclaimed that their rights are being unfairly confiscated and that they are being called upon to make the equivalent of a further financial contribution to the compromise or arrangement. Judges have observed on a number of occasions that CCAA proceedings involve "a balancing of prejudices," inasmuch as everyone is adversely affected in some fashion.

118 Here, the debtor corporations being restructured represent the issuers of the more than $32 billion in non-bank sponsored ABCP Notes. The proposed compromise and arrangement affects that entire segment of the ABCP market and the financial markets as a whole. In that respect, the application judge was correct in adverting to the importance of the restructuring to the resolution of the ABCP liquidity crisis and to the need to restore confidence in the financial system in Canada. He was required to consider and balance the interests of *all* Noteholders, not just the interests of the appellants, whose notes represent only about 3% of that total. That is what he did.

119 The application judge noted at para. 126 that the Plan represented "a reasonable balance between benefit to all Noteholders and enhanced recovery for those who can make out specific claims in fraud" within the fraud carve-out provisions of the releases. He also recognized at para. 134 that:

> No Plan of this size and complexity could be expected to satisfy all affected by it. The size of the majority who have approved it is testament to its overall fairness. No plan to address a crisis of this magnitude can work perfect equity among all stakeholders.

120 In my view we ought not to interfere with his decision that the Plan is fair and reasonable in all the circumstances.

D. Disposition

121 For the foregoing reasons, I would grant leave to appeal from the decision of Justice Campbell, but dismiss the appeal.

J.I. Laskin J.A.:

I agree.

E.A. Cronk J.A.:

I agree.

Schedule A — Conduits

Apollo Trust

Apsley Trust

Aria Trust

Aurora Trust

Comet Trust

Encore Trust

Gemini Trust

Ironstone Trust

MMAI-I Trust

Newshore Canadian Trust

Opus Trust

Planet Trust

Rocket Trust

Selkirk Funding Trust

Silverstone Trust

Slate Trust

Structured Asset Trust

Structured Investment Trust III

Symphony Trust

Whitehall Trust

Schedule B — Applicants

ATB Financial

Caisse de dépôt et placement du Québec

Canaccord Capital Corporation

Canada Mortgage and Housing Corporation

Canada Post Corporation

Credit Union Central Alberta Limited

Credit Union Central of BC

Credit Union Central of Canada

Credit Union Central of Ontario

Credit Union Central of Saskatchewan

Desjardins Group

Magna International Inc.

National Bank of Canada/National Bank Financial Inc.

NAV Canada

Northwater Capital Management Inc.

Public Sector Pension Investment Board

The Governors of the University of Alberta

Schedule A — Counsel

1) Benjamin Zarnett and Frederick L. Myers for the Pan-Canadian Investors Committee

2) Aubrey E. Kauffman and Stuart Brotman for 4446372 Canada Inc. and 6932819 Canada Inc.

3) Peter F.C. Howard and Samaneh Hosseini for Bank of America N.A.; Citibank N.A.; Citibank Canada, in its capacity as Credit Derivative Swap Counterparty and not in any other capacity; Deutsche Bank AG; HSBC Bank Canada; HSBC Bank USA, National Association; Merrill Lynch International; Merill Lynch Capital Services, Inc.; Swiss Re Financial Products Corporation; and UBS AG

4) Kenneth T. Rosenberg, Lily Harmer and Max Starnino for Jura Energy Corporation and Redcorp Ventures Ltd.

5) Craig J. Hill and Sam P. Rappos for the Monitors (ABCP Appeals)

6) Jeffrey C. Carhart and Joseph Marin for Ad Hoc Committee and Pricewaterhouse Coopers Inc., in its capacity as Financial Advisor

7) Mario J. Forte for Caisse de Dépôt et Placement du Québec

8) John B. Laskin for National Bank Financial Inc. and National Bank of Canada

9) Thomas McRae and Arthur O. Jacques for Ad Hoc Retail Creditors Committee (Brian Hunter, et al)

10) Howard Shapray, Q.C. and Stephen Fitterman for Ivanhoe Mines Ltd.

11) Kevin P. McElcheran and Heather L. Meredith for Canadian Banks, BMO, CIBC RBC, Bank of Nova Scotia and T.D. Bank

12) Jeffrey S. Leon for CIBC Mellon Trust Company, Computershare Trust Company of Canada and BNY Trust Company of Canada, as Indenture Trustees

13) Usman Sheikh for Coventree Capital Inc.

14) Allan Sternberg and Sam R. Sasso for Brookfield Asset Management and Partners Ltd. and Hy Bloom Inc. and Cardacian Mortgage Services Inc.

15) Neil C. Saxe for Dominion Bond Rating Service

16) James A. Woods, Sebastien Richemont and Marie-Anne Paquette for Air Transat A.T. Inc., Transat Tours Canada Inc., The Jean Coutu Group (PJC) Inc., Aéroports de Montréal, Aéroports de Montréal Capital Inc., Pomerleau Ontario Inc., Pomerleau Inc., Labopharm Inc., Agence Métropolitaine de Transport (AMT), Giro Inc., Vêtements de sports RGR Inc., 131519 Canada Inc., Tecsys Inc., New Gold Inc. and Jazz Air LP

17) Scott A. Turner for Webtech Wireless Inc., Wynn Capital Corporation Inc., West Energy Ltd., Sabre Energy Ltd., Petrolifera Petroleum Ltd., Vaquero Resources Ltd., and Standard Energy Ltd.

18) R. Graham Phoenix for Metcalfe & Mansfield Alternative Investments II Corp., Metcalfe & Mansfield Alternative Investments III Corp., Metcalfe & Mansfield Alternative Investments V Corp., Metcalfe & Mansfield Alternative Investments XI Corp., Metcalfe & Mansfield Alternative Investments XII Corp., Quanto Financial Corporation and Metcalfe & Mansfield Capital Corp.

Application granted; appeal dismissed.

Footnotes

* Leave to appeal refused at *ATB Financial v. Metcalfe & Mansfield Alternative Investments II Corp.* (2008), 2008 CarswellOnt 5432, 2008 CarswellOnt 5433 (S.C.C.).

1 Section 5.1 of the CCAA specifically authorizes the granting of releases to directors in certain circumstances.

2 Justice Georgina R. Jackson and Dr. Janis P. Sarra, "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* (Vancouver: Thomson Carswell, 2007).

3 Citing Gibbs J.A. in *Chef Ready Foods*, *supra*, at pp.319-320.

4 The Legislative Debates at the time the CCAA was introduced in Parliament in April 1933 make it clear that the CCAA is patterned after the predecessor provisions of s. 425 of the *Companies Act 1985* (U.K.): see *House of Commons Debates (Hansard)*, *supra*.

5 See *Canada Business Corporations Act*, R.S.C. 1985, c. C-44, s. 192; *Ontario Business Corporations Act*, R.S.O. 1990, c. B.16, s. 182.

6 A majority in number representing two-thirds in value of the creditors (s. 6)

7 *Steinberg Inc.* was originally reported in French: *Steinberg Inc. c. Michaud*, [1993] R.J.Q. 1684 (C.A. Que.). All paragraph references to *Steinberg Inc.* in this judgment are from the unofficial English translation available at 1993 CarswellQue 2055 (C.A. Que.)

8 Reed Dickerson, *The Interpretation and Application of Statutes* (1975) at pp.234-235, cited in Bryan A. Garner, ed., Black's Law Dictionary, 8th ed. (West Group, St. Paul, Minn., 2004) at 621.

TAB B

2008 CarswellOnt 3523
Ontario Superior Court of Justice [Commercial List]

ATB Financial v. Metcalfe & Mansfield Alternative Investments II Corp.

2008 CarswellOnt 3523, [2008] O.J. No. 2265, 168 A.C.W.S. (3d) 244, 43 C.B.R. (5th) 269, 47 B.L.R. (4th) 74

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 and Arrangement Involving Metcalfe & Mansfield Alternative Investments II Corp., Metcalfe & Mansfield Alternative Investments III Corp., Metcalfe & Mansfield Alternative Investments V Corp., Metcalfe & Mansfield Alternative Investments XI Corp., Metcalfe & Mansfield Alternative Investments XII Corp., 6932819 Canada Inc. and 4446372 Canada Inc., Trustees of the Conduits Listed in Schedule "A" Hereto

The Investors Represented on the Pan-Canadian Investors Committee for Third-Party Structured Asset-Backed Commercial Paper Listed in Schedule "B" Hereto (Applicants) and Metcalfe & Mansfield Alternative Investments II Corp., Metcalfe & Mansfield Alternative Investments III, Corp., Metcalfe & Mansfield Alternative Investments V Corp., Metcalfe & Mansfield Alternative Investments XI, Corp., Metcalfe & Mansfield Alternative Investments XII, Corp., 6932819 Canada Inc. and 4446372 Canada Inc., Trustees of the Conduits Listed in Schedule "A" Hereto (Respondents)

C. Campbell J.

Heard: May 12-13, 2008; June 3, 2008
Judgment: June 5, 2008
Docket: 08-CL-7440

Counsel: B. Zarnett, F. Myers, B. Empey, for Applicants
Donald Milner, Graham Phoenix, Xeno C. Martis, David Lemieux, Robert Girard, for Respondents, Metcalfe & Mansfield Alternative Investments II Corp., Metcalfe & Mansfield Alternative Investments III Corp., Metcalfe & Mansfield Alternative Investments V Corp., Metcalfe & Mansfield Alternative Investments XI Corp., Metcalfe & Mansfield Alternative Investments XII Corp.
Aubrey Kauffman, Stuart Brotman, for Respondents, 4446372 Canada Inc., 6932819 Canada Inc., as Issuer Trustees

Subject: Insolvency; Corporate and Commercial

Headnote

Bankruptcy and insolvency --- Proposal — Companies' Creditors Arrangement Act — Arrangements — Approval by court — Miscellaneous issues

Releases — Parties were financial institutions, dealers and noteholders in market for Asset Backed Commercial Paper ("ABCP") — Canadian ABCP market experienced liquidity crisis — Plan of Compromise and Arrangement ("Plan") was put forward under Companies' Creditors Arrangement Act ("CCAA") — Plan included Releases for claims against banks and dealers in negligence, misrepresentation and fraud, with "carve out" allowing fraudulent misrepresentations claims — Noteholders voted in favour of Plan — Minority of noteholders ("opponents") opposed Plan based on Releases — Applicants brought application for approval of Plan — Application granted — CCAA provided jurisdiction to approve Releases since they were appropriate for success of Plan — Decisions cited by opponents were not helpful as they concerned releases that did not extend to third party or that did not directly involve company — In case at bar, parties released were directly involved in company, and opponents' claims were

directly related to value of company — Releases were fair and reasonable — Given purpose of CCAA, it was reasonable to compromise claims to complete restructuring — Carve out balanced benefits to noteholders and recovery for fraud — No plan brought forward would permit fraud claims urged by opponents — Plan would be withdrawn without Releases — Plan was legitimate use of CCAA to restore confidence in Canadian financial system.

Table of Authorities

Cases considered by *C. Campbell J.*:

ATB Financial v. Metcalfe & Mansfield Alternative Investments II Corp. (2008), 2008 CarswellOnt 2653, 42 C.B.R. (5th) 102 (Ont. S.C.J. [Commercial List]) — referred to

ATB Financial v. Metcalfe & Mansfield Alternative Investments II Corp. (2008), 2008 CarswellOnt 2820 (Ont. S.C.J. [Commercial List]) — referred to

Canadian Airlines Corp., Re (2000), [2000] 10 W.W.R. 269, 20 C.B.R. (4th) 1, 84 Alta. L.R. (3d) 9, 9 B.L.R. (3d) 41, 2000 CarswellAlta 662, 2000 ABQB 442, 265 A.R. 201 (Alta. Q.B.) — considered

Canadian Red Cross Society / Société Canadienne de la Croix-Rouge, Re (1998), 1998 CarswellOnt 3346, 5 C.B.R. (4th) 299, 72 O.T.C. 99 (Ont. Gen. Div. [Commercial List]) — considered

Continental Insurance Co. v. Dalton Cartage Co. (1982), 25 C.P.C. 72, [1982] 1 S.C.R. 164, 131 D.L.R. (3d) 559, (sub nom. *Dalton Cartage Ltd. v. Continental Insurance Co.)* 40 N.R. 135, [1982] I.L.R. 1-1487, 1982 CarswellOnt 372, 1982 CarswellOnt 719 (S.C.C.) — considered

Ecolab Ltd. v. Greenspace Services Ltd. (1996), 1996 CarswellOnt 3788 (Ont. Gen. Div.) — referred to

Kripps v. Touche Ross & Co. (1997), 1997 CarswellBC 925, 89 B.C.A.C. 288, 145 W.A.C. 288, 35 C.C.L.T. (2d) 60, [1997] 6 W.W.R. 421, 33 B.C.L.R. (3d) 254 (B.C. C.A.) — considered

Muscletech Research & Development Inc., Re (2006), 25 C.B.R. (5th) 231, 2006 CarswellOnt 6230 (Ont. S.C.J.) — considered

Muscletech Research & Development Inc., Re (2007), 30 C.B.R. (5th) 59, 2007 CarswellOnt 1029 (Ont. S.C.J. [Commercial List]) — considered

NBD Bank, Canada v. Dofasco Inc. (1999), 1999 CarswellOnt 4077, 1 B.L.R. (3d) 1, 181 D.L.R. (4th) 37, 46 O.R. (3d) 514, 47 C.C.L.T. (2d) 213, 127 O.A.C. 338, 15 C.B.R. (4th) 67 (Ont. C.A.) — distinguished

Olympia & York Developments Ltd. v. Royal Trust Co. (1993), 17 C.B.R. (3d) 1, (sub nom. *Olympia & York Developments Ltd., Re)* 12 O.R. (3d) 500, 1993 CarswellOnt 182 (Ont. Gen. Div.) — considered

Peek v. Derry (1889), 14 H. of L. 337, 38 W.R. 33, 1 Megones Companies Act Cas 292, L.R. 14 App. Cas. 337, [1886-1890] All E.R. Rep. 1, 58 L.J. Ch. 864, 61 L.T. 265, 54 J.P. 148, 5 T.L.R. 625, 14 A.C. 337 (U.K. H.L.) — referred to

Steinberg Inc. c. Michaud (1993), [1993] R.J.Q. 1684, 55 Q.A.C. 298, 1993 CarswellQue 229, 1993 CarswellQue 2055, 42 C.B.R. (5th) 1 (Que. C.A.) — considered

Stelco Inc., Re (2005), 2005 CarswellOnt 6483, 15 C.B.R. (5th) 297 (Ont. S.C.J. [Commercial List]) — 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

Stelco Inc., Re (2007), 2007 ONCA 483, 2007 CarswellOnt 4108, 35 C.B.R. (5th) 174, 32 B.L.R. (4th) 77, 226 O.A.C. 72 (Ont. C.A.) — considered

Toronto Dominion Bank v. Leigh Instruments Ltd. (Trustee of) (1998), 1998 CarswellOnt 2565, 63 O.T.C. 1, 40 B.L.R. (2d) 1 (Ont. Gen. Div. [Commercial List]) — followed

U.S. v. Energy Resources Co. (1990), 495 U.S. 545, 65 A.F.T.R.2d 90-1078, 58 U.S.L.W. 4609, 109 L.Ed.2d 580, 110 S.Ct. 2139 (U.S. Sup. Ct.) — considered

Vicwest, Re (2003), 2003 CarswellOnt 3600 (Ont. S.C.J. [Commercial List]) — referred to

Statutes considered:

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

s. 5 — referred to

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

Interpretation Act, R.S.C. 1985, c. I-21
s. 10 — considered

Negligence Act, R.S.O. 1990, c. N.1
Generally — referred to

Words and phrases considered:

fraud

The definition of fraud in a corporate context in the common law of Canada starts with the proposition that it must be made (1) knowingly; (2) without belief in its truth; (3) recklessly, careless whether it be true or false. . . . It is my understanding that while expressed somewhat differently, the above-noted ingredients form the basis of fraud claims in the civil law of Quebec, although there are differences.

APPLICATION for approval of Plan of Compromise and Arrangement under *Companies' Creditors Arrangement Act* to address liquidity crisis in market for Asset Backed Commercial Paper.

***C. Campbell J.*:**

1 This decision follows a sanction hearing in parts in which applicants sought approval of a Plan under the *Companies Creditors Arrangement Act* ("CCAA.") Approval of the Plan as filed and voted on by Noteholders was opposed by a

number of corporate and individual Noteholders, principally on the basis that this Court does not have the jurisdiction under the CCAA or if it does should not exercise discretion to approve third party releases.

History of Proceedings

2 On Monday, March 17, 2008, two Orders were granted. The first, an Initial Order on essentially an *ex parte* basis and in a form that has become familiar to insolvency practitioners, granted a stay of proceedings, a limitation of rights and remedies, the appointment of a Monitor and for service and notice of the Order.

3 The second Order made dated March 17, 2008 provided for a meeting of Noteholders and notice thereof, including the sending of what by then had become the Amended Plan of Compromise and Arrangement. Reasons for Decision were issued on April 8, 2008 elaborating on the basis of the Initial Order.

4 No appeal was taken from either of the Orders of March 17, 2008. Indeed, on the return of a motion made on April 23, 2008 by certain Noteholders (the moving parties) to adjourn the meeting then scheduled for and held on April 25, 2008, no challenge was made to the Initial Order.

5 Information was sought and provided on the issue of classification of Noteholders. The thrust of the Motions was and has been the validity of the releases of various parties provided for in the Plan.

6 The cornerstone to the material filed in support of the Initial Order was the affidavit of Purdy Crawford, O.C., Q.C., Chairman of the Applicant Pan Canadian Investors Committee. There has been no challenge to Mr. Crawford's description of the Asset Backed Commercial Paper ("ABCP") market or in general terms the circumstances that led up to the liquidity crisis that occurred in the week of August 13, 2007, or to the formation of the Plan now before the Court.

7 The unchallenged evidence of Mr. Crawford with respect to the nature of the ABCP market and to the development of the Plan is a necessary part of the consideration of the fairness and indeed the jurisdiction, of the Court to approve the form of releases that are said to be integral to the Plan.

8 As will be noted in more detail below, the meeting of Noteholders (however classified) approved the Plan overwhelmingly at the meeting of April 25, 2008.

Background to the Plan

9 Much of the description of the parties and their relationship to the market are by now well known or referred to in the earlier reasons of March 17 or April 4, 2008.

10 The focus here will be on that portion of the background that is necessary for an understanding of and decision on, the issues raised in opposition to the Plan.

11 Not unlike a sporting event that is unfamiliar to some attending without a program, it is difficult to understand the role of various market participants without a description of it. Attached as Appendix 2 are some of the terms that describe the parties, which are from the Glossary that is part of the Information Statement, attached to various of the Monitor's Reports.

12 A list of these entities that fall into various definitional categories reveals that they comprise Canadian chartered banks, Canadian investment houses and foreign banks and financial institutions that may appear in one or more categories of conduits, dealers, liquidity providers, asset providers, sponsors or agents.

13 The following paragraphs from Mr. Crawford's affidavit succinctly summarize the proximate cause of the liquidity crisis, which since August 2007 has frozen the market for ABCP in Canada:

> [7] Before the week of August 13, 2007, there was an operating market in ABCP. Various corporations (referred to below as "Sponsors") arranged for the Conduits to make ABCP available as an investment vehicle bearing interest at rates slightly higher than might be available on government or bank short-term paper.
>
> [8] The ABCP represents debts owing by the trustees of the Conduits. Most of the ABCP is short-term commercial paper (usually 30 to 90 days). The balance of the ABCP is made up of commercial paper that is extendible for up to 364 days and longer-term floating rate notes. The money paid by investors to acquire ABCP was used to purchase a portfolio of financial assets to be held, directly or through subsidiary trusts, by the trustees of the Conduits. Repayment of each series of ABCP is supported by the assets held for that series, which serves as collateral for the payment obligations. ABCP is therefore said to be "asset-backed."
>
> [9] Some of these supporting assets were mid-term, but most were long-term, such as pools of residential mortgages, credit card receivables or credit default swaps (which are sophisticated derivative products). Because of the generally long-term nature of the assets backing the ABCP, the cash flow they generated did not match the cash flow required to repay maturing ABCP. Before mid-August 2007, this timing mismatch was not a problem because many investors did not require repayment of ABCP on maturity; instead they reinvested or "rolled" their existing ABCP at maturity. As well, new ABCP was continually being sold, generating funds to repay maturing ABCP where investors required payment. Many of the trustees of the Conduits also entered into back-up liquidity arrangements with third-party lenders ("Liquidity Providers") who agreed to provide funds to repay maturing ABCP in certain circumstances.
>
> [10] In the week of August 13, 2007, the ABCP market froze. The crisis was largely triggered by market sentiment, as news spread of significant defaults on U.S. sub-prime mortgages. In large part, investors in Canadian ABCP lost confidence because they did not know what assets or mix of assets backed their ABCP. Because of this lack of transparency, existing holders and potential new investors feared that the assets backing the ABCP might include sub-prime mortgages or other overvalued assets. Investors stopped buying new ABCP, and holders stopped "rolling" their existing ABCP. As ABCP became due, Conduits were unable to fund repayments through new issuances or replacement notes. Trustees of some Conduits made requests for advances under the back-up arrangements that were intended to provide liquidity; however, most Liquidity Providers took the position that the conditions to funding had not been met. With no new investment, no reinvestment, and no liquidity funding available, and with long-term underlying assets whose cash flows did not match maturing short-term ABCP, payments due on the ABCP could not be made — and no payments have been made since mid-August.

14 Between mid-August 2007 and the filing of the Plan, Mr. Crawford and the Applicant Committee have diligently pursued the object of restructuring not just the specific trusts that are part of this Plan, but faith in a market structure that has been a significant part of the broader Canadian financial market, which in turn is directly linked to global financial markets that are themselves in uncertain times.

15 The previous reasons of March 17, 2008 that approved for filing the Initial Plan, recognized not just the unique circumstances facing conduits and their sponsors, but the entire market in Canada for ABCP and the impact for financial markets generally of the liquidity crisis.

16 Unlike many CCAA situations, when at the time of the first appearance there is no plan in sight, much less negotiated, this rescue package has been the product of painstaking, complicated and difficult negotiations and eventually agreement.

17 The following five paragraphs from Mr. Crawford's affidavit crystallize the problem that developed in August 2007:

> [45] Investors who bought ABCP often did not know the particular assets or mix of assets that backed their ABCP. In part, this was because ABCP was often issued and sold before or at about the same time the assets

were acquired. In addition, many of the assets are extremely complex and parties to some underlying contracts took the position that the terms were confidential.

[46] Lack of transparency became a significant problem as general market fears about the credit quality of certain types of investment mounted during the summer of 2007. As long as investors were willing to roll their ABCP or buy new ABCP to replace maturing notes, the ABCP market was stable. However, beginning in the first half of 2007, the economy in the United States was shaken by what is referred to as the "sub-prime" lending crisis.

[47] U.S. sub-prime lending had an impact in Canada because ABCP investors became concerned that the assets underlying their ABCP either included U.S. sub-prime mortgages or were overvalued like the U.S. sub-prime mortgages. The lack of transparency into the pools of assets underlying ABCP made it difficult for investors to know if their ABCP investments included exposure to U.S. sub-prime mortgages or other similar products. In the week of August 13, that concern intensified to the point that investors stopped rolling their maturing ABCP, and instead demanded repayment, and new investors could not be found. Certain trustees of the Conduits then tried to draw on their Liquidity Agreements to repay ABCP. Most of the Liquidity Providers did not agree that the conditions for liquidity funding had occurred and did not provide funding, so the ABCP could not be repaid. Deteriorating conditions in the credit market affected all the ABCP, including ABCP backed by traditional assets not linked to sub-prime lending.

[48] Some of the Asset Providers made margin calls under LSS swaps on certain of the Conduits, requiring them to post additional collateral. Since they could not issue new ABCP, roll over existing ABCP or draw on their Liquidity Agreements, those Conduits were not able to post the additional collateral. Had there been no standstill arrangement, as described below, these Asset Providers could have unwound the swaps and ultimately could have liquidated the collateral posted by the Conduits.

[49] Any liquidation of assets under an LSS swap would likely have further depressed the LSS market, creating a domino effect under the remaining LSS swaps by triggering their "mark-to-market" triggers for additional margin calls, ultimately leading to the sale of more assets, at very depressed prices. The standstill arrangement has, to date, through successive extensions, prevented this from occurring, in anticipation of the restructuring.

18 The "Montreal Accord," as it has been called, brought together various industry representatives, Asset Providers and Liquidity Providers who entered into a "Standstill Agreement," which committed to the framework for restructuring the ABCP such that (a) all outstanding ABCP would be converted into term floating rate notes maturing at the same time as the corresponding underlying assets. This was intended to correct the mismatch between the long-term nature of the financial assets and the short-term nature of the ABCP; and (b) margin provisions under certain swaps would be changed to create renewed stability, reducing the likelihood of margin calls. This contract was intended to reduce the risk that the Conduits would have to post additional collateral for the swap obligations or be subject to having their assets seized and sold, thereby preserving the value of the assets and of the ABCP.

19 The Investors Committee of which Mr. Crawford is the Chair has been at work since September to develop a Plan that could be implemented to restore viability to the notes that have been frozen and restore liquidity so there can be a market for them.

20 Since the Plan itself is not in issue at this hearing (apart from the issue of the releases), it is not necessary to deal with the particulars of the Plan. Suffice to say I am satisfied that as the Information to Noteholders states at p. 69, "The value of the Notes if the Plan does not go forward is highly uncertain."

The Vote

21 A motion was held on April 25, 2008, brought by various corporate and individual Noteholders seeking:

a) changing classification each in particular circumstances from the one vote per Noteholder regime;

b) provision of information of various kinds;

c) adjourning the vote of April 25, 2008 until issues of classification and information were fully dealt with;

d) amending the Plan to delete various parties from release.

22 By endorsement of April 24, 2008 [2008 CarswellOnt 2653 (Ont. S.C.J. [Commercial List])] the issue of releases was in effect adjourned for determination later. The vote was not postponed, as I was satisfied that the Monitor would be able to tally the votes in such a way that any issue of classification could be dealt with at this hearing.

23 I was also satisfied that the Applicants and the Monitor had or would make available any and all information that was in existence and pertinent to the issue of voting. Of understandable concern to those identified as the moving parties are the developments outside the Plan affecting Noteholders holding less than $1 million of Notes. Certain dealers, Canaccord and National Bank being the most prominent, agreed in the first case to buy their customers' ABCP and in the second to extend financing assistance.

24 A logical conclusion from these developments outside the Plan is that they were designed (with apparent success) to obtain votes in favour of the Plan from various Noteholders.

25 On a one vote per Noteholder basis, the vote was overwhelmingly in favour of the Plan approximately 96%. At a case conference held on April 29, 2008, the Monitor was asked to tabulate votes that would isolate into Class A all those entities in any way associated with the formulation of the Plan, whether or not they were Noteholders or sold or advised on notes, and into Class B all other Noteholders.

26 The results of the vote on the Restructuring Resolution, tabulated on the basis set out in paragraph 30 of the Monitor's 7th Report and using the Class structure referred to in the preceding paragraph, are summarized below:

	Number		Dollar Value	
Class A				
Votes FOR the Restructuring Resolution	1,572	99.4%	$23,898, 232,639	100.0%
Votes AGAINST the Restructuring —Resolution	9	0.6%	$867,666	0.0%
CLASS B				
Votes FOR the Restructuring Resolution	289	80.5%	$5,046, 951,989	81.2%
Votes AGAINST the Restructuring— Resolution	70	19.5%	$1,168, 136,123	18.8%

27 I am satisfied that reclassification would not alter the strong majority supporting the Restructuring. The second request made at the case conference on April 29 was that the moving parties provide the Monitor with information that would permit a summary to be compiled of the claims that would have been made or anticipated to be made against so-called third parties, including Conduits and their trustees.

28 The information compiled by the Monitor reveals that the primary defendants are or are anticipated to be banks, including four Canadian chartered banks and dealers (many associated with Canadian banks). In the case of banks, they and their employees may be sued in more than one capacity.

29 The claims against proposed defendants are for the most part claims in tort, and include negligence, misrepresentation, negligent misrepresentation, failure to act prudently as a dealer/adviser, acting in conflict of interest and in a few instances, fraud or potential fraud.

30 Again in general terms, the claims for damages include the face value of notes plus interest and additional penalties and damages that may be allowable at law. It is noteworthy that the moving parties assume that they would be able to mitigate their claim for damages by taking advantage of the Plan offer without the need to provide releases.

31 The information provided by the potential defendants indicates the likelihood of claims over against parties such that no entity, institution or party involved in the Restructuring Plan could be assured being spared from likely involvement in lawsuits by way of third party or other claims over.

32 The chart prepared by the Monitor that is Appendix 3 to these Reasons shows graphically the extent of those entities that would be involved in future litigation.

Law and Analysis

33 Some of the moving parties in their written and oral submissions assumed that this Court has the power to amend the Plan to allow for the proposed lawsuits, whether in negligence or fraud. The position of the Applicants and supporting parties is that the Plan is to be accepted on the basis that it satisfies the criteria established under the CCAA, or it will be rejected on the basis that it does not.

34 I am satisfied that the Court does not have the power to amend the Plan. The Plan is that of the Applicants and their supporters. They have made it clear that the Plan is a package that allows only for acceptance or rejection by the Court. The Plan has been amended to address the concerns expressed by the Court in the May 16, 2008 [2008 CarswellOnt 2820 (Ont. S.C.J. [Commercial List])] endorsement.

35 I am satisfied and understand that if the Plan is rejected by the Court, either on the basis of fairness (i.e., that claims should be allowed to proceed beyond those provided for in the Plan) or lack of jurisdiction to compel compromise of claims, there is no reliable prospect that the Plan would be revised.

36 I do not consider that the Applicants or those supporting them are bluffing or simply trying to bargain for the best position for themselves possible. The position has been consistent throughout and for what I consider to be good and logical reasons. Those parties described as Asset or Liquidity Providers have a first secured interest in the underlying assets of the Trusts. To say that the value of the underlying assets is uncertain is an understatement after the secured interest of Asset Providers is taken into account.

37 When one looks at the Plan in detail, its intent is to benefit ALL Noteholders. Given the contribution to be made by those supporting the Plan, one can understand why they have said forcefully in effect to the Court, 'We have taken this as far as we can, particularly given the revisions. If it is not accepted by the Court as it has been overwhelmingly by Noteholders, we hold no prospect of another Plan coming forward.'

38 I have carefully considered the submissions of all parties with respect to the issue of releases. I recognize that to a certain extent the issues raised chart new territory. I also recognize that there are legitimate principle-based arguments on both sides.

39 As noted in the Reasons of April 8, 2008 and as reflected in the March 17, 2008 Order and May 16 Endorsement, the Plan represents a highly complex unique situation.

40 The vehicles for the Initial Order are corporations acting in the place of trusts that are insolvent. The trusts and the respondent corporations are not directly related except in the sense that they are all participants in the Canadian market for ABCP. They are each what have been referred to as issuer trustees.

41 There are a great number of other participants in the ABCP market in Canada who are themselves intimately connected with the Plan, either as Sponsors, Asset Providers, Liquidity Providers, participating banks or dealers.

42 I am satisfied that what is sought in this Plan is the restructuring of the ABCP market in Canada and not just the insolvent corporations that are issuer trustees.

43 The impetus for this market restructuring is the Investors Committee chaired by Mr. Crawford. It is important to note that all of the members of the Investors Committee, which comprise 17 financial and investment institutions (see Schedule B, attached), are themselves Noteholders with no other involvement. Three of the members of that Committee act as participants in other capacities.

44 The Initial Order, which no party has appealed or sought to vary or set aside, accepts for the purpose of placing before all Noteholders the revised Plan that is currently before the Court.

45 Those parties who now seek to exclude only some of the Release portions of the Plan do not take issue with the legal or practical basis for the goal of the Plan. Indeed, the statement in the Information to Noteholders, which states that

> ...as of August 31, 2007, of the total amount of Canadian ABCP outstanding of approximately $116.8 billion (excluding medium-term and floating rate notes), approximately $83.8 billion was issued by Canadian Schedule I bank-administered Conduits and approximately $33 billion was issued by non-bank administered conduits) [1]

is unchallenged.

46 The further description of the ABCP market is also not questioned:

> ABCP programs have been used to fund the acquisition of long-term assets, such as mortgages and auto loans. Even when funding short-term assets such as trade receivables, ABCP issuers still face the inherent timing mismatch between cash generated by the underlying assets and the cash needed to repay maturing ABCP. Maturing ABCP is typically repaid with the proceeds of newly issued ABCP, a process commonly referred to as "rolling". Because ABCP is a highly rated commercial obligation with a long history of market acceptance, market participants in Canada formed the view that, absent a "general market disruption", ABCP would readily be saleable without the need for extraordinary funding measures. However, to protect investors in case of a market disruption, ABCP programs typically have provided liquidity back-up facilities, usually in amounts that correspond to the amount of the ABCP programs typically have provided liquidity back-up facilities, usually in amounts that correspond to the amount of the ABCP outstanding. In the event that an ABCP issuer is unable to issue new ABCP, it may be able to draw down on the liquidity facility to ensure that proceeds are available to repay any maturing ABCP. As discussed below, there have been important distinctions between different kinds of liquidity agreements as to the nature and scope of drawing conditions which give rise to an obligation of a liquidity provider to fund [2]

47 The activities of the Investors Committee, most of whom are themselves Noteholders without other involvement, have been lauded as innovative, pioneering and essential to the success of the Plan. In my view, it is entirely inappropriate to classify the vast majority of the Investors Committee, and indeed other participants who were not directly engaged in the sale of Notes, as third parties.

48 Given the nature of the ABCP market and all of its participants, it is more appropriate to consider all Noteholders as claimants and the object of the Plan to restore liquidity to the assets being the Notes themselves. The restoration of the liquidity of the market necessitates the participation (including more tangible contribution by many) of all Noteholders.

49 In these circumstances, it is unduly technical to classify the Issuer Trustees as debtors and the claims of Noteholders as between themselves and others as being those of third party creditors, although I recognize that the restructuring structure of the CCAA requires the corporations as the vehicles for restructuring.

50 The insolvency is of the ABCP market itself, the restructuring is that of the market for such paper - restructuring that involves the commitment and participation of all parties. The Latin words *sui generis* are used to mean something that is "one off" or "unique." That is certainly the case with this Plan.

51 The Plan, including all of its constituent parts, has been overwhelmingly accepted by Noteholders no matter how they are classified. In the sense of their involvement I do not think it appropriate to label any of the participants as Third Parties. Indeed, as this matter has progressed, additions to the supporter side have included for the proposed releases the members of the Ad Hoc Investors' Committee. The Ad Hoc group had initially opposed the release provisions. The Committee members account for some two billion dollars' worth of Notes.

52 It is more appropriate to consider all participants part of the market for the restructuring of ABCP and therefore not merely third parties to those Noteholders who may wish to sue some or all of them.

53 The benefit of the restructuring is only available to the debtor corporations with the input, contribution and direct assistance of the Applicant Noteholders and those associated with them who similarly contribute. Restructuring of the ABCP market cannot take place without restructuring of the Notes themselves. Restructuring of the Notes cannot take place without the input and capital to the insolvent corporations that replace the trusts.

54 A hearing was held on May 12 and 13 to hear the objections of various Noteholders to approval of the Plan insofar as it provided for comprehensive releases.

55 On May 16, 2008, by way of endorsement the issue of scope of the proposed releases was addressed. The following paragraphs from the endorsement capsulize the adjournment that was granted on the issue of releases:

> [10] I am not satisfied that the release proposed as part of the Plan, which is broad enough to encompass release from fraud, is in the circumstances of this case at this time properly authorized by the CCAA, or is necessarily fair and reasonable. I simply do not have sufficient facts at this time on which to reach a conclusion one way or another.
>
> [11] I have also reached the conclusion that in the circumstances of this Plan, at this time, it may well be appropriate to approve releases that would circumscribe claims for negligence. I recognize the different legal positions but am satisfied that this Plan will not proceed unless negligence claims are released.

56 The endorsement went on to elaborate on the particular concerns that I had with releases sought by the Applicants that could in effect exonerate fraud. As well, concern was expressed that the Plan might unduly bring hardship to some Noteholders over others.

57 I am satisfied that based on Mr. Crawford's affidavit and the statements commencing at p. 126 of the Information to Noteholders, a compelling case for the need for comprehensive releases, with the exception of certain fraud claims, has been made out.

> The Released Parties have made comprehensive releases a condition of their participation in the Plan or as parties to the Approved Agreements. Each Released Party is making a necessary contribution to the Plan without which the Plan cannot be implemented. The Asset Providers, in particular, have agreed to amend certain of the existing contracts and/or enter into new contracts that, among other things, will restructure the trigger covenants, thereby increasing their risk of loss and decreasing the risk of losses being borne by Noteholders. In addition, the Asset Providers are making further contributions that materially improve the position of Noteholders generally, including through forebearing from making collateral calls since August 15, 2007, participating in the MAV2 Margin Funding Facility at pricing favourable to the Noteholders, accepting additional collateral at par with respect to the Traditional Assets and disclosing confidential information, none of which they are contractually obligated to do. The ABCP Sponsors have also released confidential information, co-operated with the Investors Committee

> and its advisors in the development of the Plan, released their claims in respect of certain future fees that would accrue to them in respect of the assets and are assisting in the transition of administration services to the Asset Administrator, should the Plan be implemented. The Original Issuer Trustees, the Issuer Trustees, the Existing Note Indenture Trustees and the Rating Agency have assisted in the restructuring process as needed and have co-operated with the Investors Committee in facilitating an essential aspect of the court proceedings required to complete the restructuring of the ABCP Conduits through the replacement of the Original Issuer Trustees where required.
>
> In many instances, a party had a number of relationships in different capacities with numerous trades or programs of an ABCP Conduit, rendering it difficult or impracticable to identify and/or quantify any individual Released Party's contribution. Certain of the Released Parties may have contributed more to the Plan than others. However, in order for the releases to be comprehensive, the Released Parties (including those Released Parties without which no restructuring could occur) require that all Released Parties be included so that one Person who is not released by the Noteholders is unable to make a claim-over for contribution from a Released Party and thereby defeat the effectiveness of the releases. Certain entities represented on the Investors Committee have also participated in the Third-Party ABCP market in a variety of capacities other than as Noteholders and, accordingly, are also expected to benefit from these releases.

The evidence is unchallenged.

58 The questions raised by moving parties are (a) does the Court have jurisdiction to approve a Plan under the CCAA that provides for the releases in question?; and if so, (b) is it fair and reasonable that certain identified dealers and others be released?

59 I am also satisfied that those parties and institutions who were involved in the ABCP market directly at issue and those additional parties who have agreed solely to assist in the restructuring have valid and legitimate reasons for seeking such releases. To exempt some Noteholders from release provisions not only leads to the failure of the Plan, it does likely result in many Noteholders having to pursue fraud or negligence claims to obtain any redress, since the value of the assets underlying the Notes may, after first security interests be negligible.

Restructuring under the CCAA

60 This Application has brought into sharp focus the purpose and scope of the CCAA. It has been accepted for the last 15 years that the issue of releases beyond directors of insolvent corporations dates from the decision in *Canadian Airlines Corp., Re*[3] where Paperny J. said:

> [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.

61 The following paragraphs from that decision are reproduced at some length, since, in the submission principally of Mr. Woods, the releases represent an illegal or improper extension of the wording of the CCAA. Mr. Woods takes issue with the reasoning in the *Canadian Airlines* decision, which has been widely referred to in many cases since. Mme Justice Paperny continued:

> [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.
>
> ...
>
> [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. [Emphasis added.]
>
> [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.
>
> [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 and York Dev. Ltd. v. Royal Trust Co.* [4] 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.*, [1989] 2 W.W.R. 566 at 574 (Alta.Q.B.); *Northland Properties Ltd. v. Excelsior Life Insurance Co. of Canada*, [1989] 3 W.W.R. 363 at 368 (B.C.C.A.).
>
> [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.

[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.

62 The liberal interpretation to be given to the CCAA was and has been accepted in Ontario. In *Canadian Red Cross Society / Société Canadienne de la Croix-Rouge, Re*[5], Blair J. (as he then was) has been referred to with approval in later cases:

> [45] It is very common in CCAA restructurings for the Court to approve the sale and disposition of assets during the process and before the Plan if formally tendered and voted upon. There are many examples where this had occurred, the recent Eaton's restructuring being only one of them. The CCAA is designed to be a flexible instrument, and it is that very flexibility which gives it its efficacy. As Farley J said in *Dylex Ltd.* supra (p. 111), "the history of CCAA law has been an evolution of judicial interpretation". It is not infrequently that judges are told, by those opposing a particular initiative at a particular time, that if they make a particular order that is requested it will be the first time in Canadian jurisprudence (sometimes in global jurisprudence, depending upon the level of the rhetoric) that such an order has made! Nonetheless, the orders are made, if the circumstances are appropriate and the orders can be made within the framework and in the spirit of the CCAA legislation. Mr. Justice Farley has well summarized this approach in the following passage from his decision in *Lehndorff General Partner Ltd., Re* (1993), 17 C.B.R. (3d) 24 (Ont. Gen. Div. [Commercial List]), at p. 31, which I adopt:
>
> > 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 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 4,5,7,8 and 11 of the CCAA (a lengthy list of authorities cited here is omitted).
> >
> > 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 (citations omitted)
>
> [Emphasis added]

63 In a 2006 decision in *Muscletech Research & Development Inc., Re*[6], which adopted the *Canadian Airlines* test, Ground J. said:

> [7] With respect to the relief sought relating to Claims against Third Parties, the position of the Objecting Claimants appears to be that this court lacks jurisdiction to make any order affecting claims against third parties who are not applicants in a CCAA proceeding. I do not agree. In the case at bar, the whole plan of compromise which is being funded by Third Parties will not proceed unless the plan provides for a resolution of all claims against the Applicants and Third Parties arising out of "the development, advertising and marketing, and sale of health supplements, weight loss and sports nutrition or other products by the Applicants or any of them" as part of a global resolution of the litigation commenced in the United States. In his Endorsement of January 18, 2006, Farley J. stated:
>
> > the Product Liability system vis-à-vis the Non-Applicants appears to be in essence derivative of claims against the Applicants and it would neither be logical nor practical/functional to have that Product Liability litigation not be dealt with on an all encompassing basis.

64 This decision is also said to be beyond the Court's jurisdiction to follow.

65 In a later decision[7] in the same matter, Ground J. said in 2007:

> [18] It has been held that in determining whether to sanction a plan, the court must exercise its equitable jurisdiction and consider the prejudice to the various parties that would flow from granting or refusing to grant approval of the plan and must consider alternatives available to the Applicants if the plan is not approved. An important factor to be considered by the court in determining whether the plan is fair and reasonable is the degree of approval given to the plan by the creditors. It has also been held that, in determining whether to approve the plan, a court should not second-guess the business aspects of the plan or substitute its views for that of the stakeholders who have approved the plan.
>
> [19] In the case at bar, all of such considerations, in my view must lead to the conclusion that the Plan is fair and reasonable. On the evidence before this court, the Applicants have no assets and no funds with which to fund a distribution to creditors. Without the Contributed Funds there would be no distribution made and no. Plan to be sanctioned by this court. Without the Contributed Funds, the only alternative for the Applicants is bankruptcy and it is clear from the evidence before this court that the unsecured creditors would receive nothing in the event of bankruptcy.
>
> [20] A unique feature of this Plan is the Releases provided under the Plan to Third Parties in respect of claims against them in any way related to "the research, development, manufacture, marketing, sale, distribution, application, advertising, supply, production, use or ingestion of products sold, developed or distributed by or on behalf of" the Applicants (see Article 9.1 of the Plan). It is self-evident, and the Subject Parties have confirmed before this court, that the Contributed Funds would not be established unless such Third Party Releases are provided and accordingly, in my view it is fair and reasonable to provide such Third Party releases in order to establish a fund to provide for distributions to creditors of the Applicants. With respect to support of the Plan, in addition to unanimous approval of the Plan by the creditors represented at meetings of creditors, several other stakeholder groups support the sanctioning of the Plan, including lovate Health Sciences Inc. and its subsidiaries (excluding the Applicants) (collectively, the "lovate Companies"), the Ad Hoc Committee of

> Muscle Tech Tort Claimants, GN Oldco, Inc. f/k/a General Nutrition Corporation, Zurich American Insurance Company, Zurich Insurance Company, HVL, Inc. and XL Insurance America Inc. It is particularly significant that the Monitor supports the sanctioning of the Plan.
>
> [21] With respect to balancing prejudices, if the Plan is not sanctioned, in addition to the obvious prejudice to the creditors who would receive nothing by way of distribution in respect of their claims, other stakeholders and Third Parties would continue to be mired in extensive, expensive and in some cases conflicting litigation in the United States with no predictable outcome.

66 I recognize that in *Muscletech*, as in other cases such as *Vicwest, Re*,[8], there has been no direct opposition to the releases in those cases. The concept that has been accepted is that the Court does have jurisdiction, taking into account the nature and purpose of the CCAA, to sanction release of third parties where the factual circumstances are deemed appropriate for the success of a Plan.[9]

67 The moving parties rely on the decision of the Ontario Court of Appeal in *NBD Bank, Canada v. Dofasco Inc.*[10] for the proposition that compromise of claims in negligence against those associated with a debtor corporation within a CCAA context is not permitted.

68 The claim in that case was by NBD as a creditor of Algoma Steel, then under CCAA protection against its parent Dofasco and an officer of both Algoma and Dofasco. The claim was for negligent misrepresentation by which NBD was induced to advance funds to Algoma shortly before the CCAA filing.

69 In the approved CCAA order only the debtor Algoma was released. The Court of Appeal held that the benefit of the release did not extend to officers of Algoma or to the parent corporation Dofasco or its officers.

70 Rosenberg J.A. writing for the Court said:

> [51] Algoma commenced the process under the CCAA on February 18, 1991. The process was a lengthy one and the Plan of Arrangement was approved by Farley J. in April 1992. The Plan had previously been accepted by the overwhelming majority of creditors and others with an interest in Algoma. The Plan of Arrangement included the following term:
>
> **6.03 Releases**
>
> From and after the Effective Date, each Creditor and Shareholder of Algoma prior to the Effective Date (other than Dofasco) will be deemed to forever release Algoma from any and all suits, claims and causes of action that it may have had against Algoma or its directors, officers, employees and advisors. [Emphasis added.]
>
> ...
>
> [54] In fact, to refuse on policy grounds to impose liability on an officer of the corporation for negligent misrepresentation would contradict the policy of Parliament as demonstrated in recent amendments to the CCAA and the Bankruptcy and Insolvency Act, R.S.C. 1985, c. B-3. Those Acts now contemplate that an arrangement or proposal may include a term for compromise of certain types of claims against directors of the company except claims that "are based on allegations of misrepresentations made by directors". L. W. Houlden and C. H. Morawetz, the editors of The 2000 Annotated Bankruptcy and Insolvency Act (Toronto: Carswell, 1999) at p. 192 are of the view that the policy behind the provision is to encourage directors of an insolvent corporation to remain in office so that the affairs of the corporation can be reorganized. I can see no similar policy interest in barring an action against an officer of the company who, prior to the insolvency, has misrepresented the financial affairs of the corporation to its creditors. It may be necessary to permit

> the compromise of claims against the debtor corporation, otherwise it may not be possible to successfully reorganize the corporation. The same considerations do not apply to individual officers. Rather, it would seem to me that it would be contrary to good policy to immunize officers from the consequences of their negligent statements which might otherwise be made in anticipation of being forgiven under a subsequent corporate proposal or arrangement. [Reference omitted]

71 In my view, there is little factual similarity in *NBD* to the facts now before the Court. In this case, I am not aware of any claims sought to be advanced against directors of Issuer Trustees. The release of Algoma in the *NBD* case did not on its face extend to Dofasco, the third party. Accordingly, I do not find the decision helpful to the issue now before the Court. The moving parties also rely on decisions involving another steel company, Stelco, in support of the proposition that a CCAA Plan cannot be used to compromise claims as between creditors of the debtor company.

72 In *Stelco Inc., Re*, [11] Farley J., dealing with classification, said in November 2005:

> [7] The CCAA is styled as "An act to facilitate compromises and arrangements between companies and their creditors" and its short title is: *Companies' Creditors Arrangement Act*. Ss. 4, 5 and 6 talk of compromises or arrangements between a company and its creditors. There is no mention of this extending by statute to encompass a change of relationship among the creditors vis-à-vis the creditors themselves and not directly involving the company. See *Pacific Coastal Airlines Ltd. v. Air Canada*, [2001] B.C.J. No. 2580 (S.C.) at paras. 24-25; *Royal Bank of Canada v. Gentra Canada Investments Inc.*, [2000] O.J. No. 315 (S.C.J.) at para. 41, appeal dismissed [2001] O.J. No. 2344 (C.A.); *Re 843504 Alberta Ltd.*, [2003] A.J. No. 1549 (Q.B.) at para. 13; *Re Royal Oak Mines Inc.*, [1999] O.J. No. 709 (Gen. Div.) at para. 24; *Re Royal Oak Mines Inc.*, [1999] O.J. No. 864 (Gen. Div.) at para. 1.

73 The Ontario Court of Appeal dismissed the appeal from that decision. [12] Blair J.A., quoting Paperny J. in *Canadian Airlines Corp., Re, supra*, said:

> [23] In *Re Canadian Airlines Corp.* (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:
> >
> > 1. Commonality of interest should be viewed based on the non-fragmentation test, not on an identity of interest test;
> >
> > 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.
> >
> > 3. The commonality of interests are to be viewed purposively, bearing in mind the object of the C.C.C.A., namely to facilitate reorganizations if possible.
> >
> > 4. In placing a broad and purposive interpretation on the C.C.C.A., the court should be careful to resist classification approaches that would potentially jeopardize viable plans.
> >
> > 5. Absent bad faith, the motivations of creditors to approve or disapprove [of the Plan] are irrelevant.
> >
> > 6. The requirement of creditors being able to consult together means being able to assess their legal entitlement *as creditors* before or after the plan in a similar manner.
>
> [24] In developing this summary of principles, Paperny J. considered a number of authorities from across Canada, including the following: *Sklar-Peppler Furniture Corp. v. Bank of Nova Scotia* (1991), 86 D.L.R. (4th)

621 (Ont. Gen. Div.); *Norcen Energy Resources Ltd. v. Oakwood Petroleums Ltd.* (1988), 72 C.B.R. (N.S.) 20 (Alta. Q.B.); *Re Fairview Industries Ltd.* (1991), 11 C.B.R. (3d) 71 (N.S.T.D.); *Re Woodward's Ltd.* 1993 CanLII 870 (BC S.C), (1993), 84 B.C.L.R. (2d) 206 (B.C.S.C.); *Re Northland Properties Ltd.* (1988), 73 C.B.R. (N.S.) 166 (B.C.S.C.); *Northland Properties Ltd. v. Excelsior Life Insurance Co. of Canada* (1989), 73 C.B.R. (N.S.) 195 (B.C.C.A.); *Re NsC Diesel Power Inc.* (1990), 79 C.B.R. (N.S.) 1 (N.S.T.D.); *Savage v. Amoco Acquisition Co.* (1988), 68 C.B.R. (N.S.) 154, (*sub nom. Amoco Acquisition Co. v. Savage*) (Alta. C.A.); *Re Wellington Building Corp.* (1934), 16 C.B.R. 48 (Ont. H.C.J.). Her summarized principles were cited by the Alberta Court of Appeal, apparently with approval, in a subsequent *Canadian Airlines decision: Re Canadian Airlines Corp.* 2000 ABCA 149 (CanLII), (2000), 19 C.B.R. (4th) 33 (Alta. C.A.) at para. 27.

. . . . .

[32] First, as the supervising judge noted, the CCAA itself is more compendiously styled "An act to facilitate compromises and arrangements between companies and their creditors". There is no mention of dealing with issues that would change the nature of the relationships as between the creditors themselves. As Tysoe J. noted in *Pacific Coastal Airlines Ltd. v. Air Canada*, [2001] B.C.J. No. 2580 (B.C.S.C.) at para. 24 (after referring to the full style of the legislation):

> [The purpose of the CCAA proceeding] is not to deal with disputes between a creditor of a company and a third party, even if the company was also involved in the subject matter of the dispute. While issues between the debtor company and non-creditors are sometimes dealt with in CCAA proceedings, it is not a proper use of a CCAA proceeding to determine disputes between parties other than the debtor company.

[33] In this particular case, the supervising judge was very careful to say that nothing in his reasons should be taken to determine or affect the relationship between the Subordinate Debenture Holders and the Senior Debt Holders.

[34] Secondly, it has long been recognized that creditors should be classified in accordance with their contract rights, that is, according to their respective interests in the debtor company: see Stanley E. Edwards, "Reorganizations Under the Companies' Creditors Arrangement Act" (1947) 25 Can. Bar. Rev. 587, at p. 602.

[35] Finally, to hold the classification and voting process hostage to the vagaries of a potentially infinite variety of disputes as between already disgruntled creditors who have been caught in the maelstrom of a CCAA restructuring, runs the risk of hobbling that process unduly. It could lead to the very type of fragmentation and multiplicity of discrete classes or sub-classes of classes that judges and legal writers have warned might well defeat the purpose of the Act: see Stanley Edwards, "Reorganizations under the Companies' Creditors Arrangement Act", *supra*; Ronald N. Robertson Q.C., "Legal Problems on Reorganization of Major Financial and Commercial Debtors", Canadian Bar Association - Ontario Continuing Legal Education, 5th April 1983 at 19-21; *Norcen Energy Resources Ltd. v. Oakwood Petroleums Ltd., supra*, at para. 27; *Northland Properties Ltd. v. Excelsior Life Insurance Co. of Canada, supra; Sklar-Peppler, supra; Re Woodwards Ltd., supra.*

[36] In the end, it is important to remember that classification of creditors, like most other things pertaining to the CCAA, must be crafted with the underlying purpose of the CCAA in mind, namely facilitation of the reorganization of an insolvent company through the negotiation and approval of a plan of compromise or arrangement between the debtor company and its creditors, so that the debtor company can continue to carry on its business to the benefit of all concerned. As Paperny J. noted in *Re Canadian Airlines*, "the Court should be careful to resist classification approaches that would potentially jeopardize viable Plans."

74 In 2007, in *Stelco Inc., Re*[13], the Ontario Court of Appeal dismissed a further appeal and held:

> [44] We note that this approach of delaying the resolution of inter-creditor disputes is not inconsistent with the scheme of the *CCAA*. In a ruling made on November 10, 2005, in the proceedings relating to Stelco reported at 15 C.B.R. (5th) 297, Farley J. expressed this point (at para. 7) as follows:
>
> > The *CCAA* is styled as "An Act to facilitate compromises and arrangements between companies and their creditors" and its short title is: *Companies' Creditors Arrangement Act*. Ss. 4, 5 and 6 talk of compromises or arrangements between a company and its creditors. There is no mention of this extending by statute to encompass a change of relationship among the creditors *vis-à-vis* the creditors themselves and not directly involving the company.
>
> [45] Thus, we agree with the motion judge's interpretation of s. 6.01(2). The result of this interpretation is that the Plan extinguished the provisions of the Note Indenture respecting the rights and obligations as between Stelco and the Noteholders on the Effective Date. However, the Turnover Provisions, which relate only to the rights and obligations between the Senior Debt Holders and the Noteholders, were intended to continue to operate.

75 I have quoted from the above decisions at length since they support rather than detract from the basic principle that in my view is operative in this instance.

76 I do not consider that the Plan in this case involves a change in relationship among creditors "that does not directly involve the Company." Those who support the Plan and are to be released are "directly involved in the Company" in the sense that many are foregoing immediate rights to assets and are providing real and tangible input for the preservation and enhancement of the Notes. It would be unduly restrictive to suggest that the moving parties' claims against released parties do not involve the Company, since the claims are directly related to the value of the Notes. The value of the Notes is in this case the value of the Company.

77 This Plan, as it deals with releases, doesn't change the relationship of the creditors apart from involving the Company and its Notes. The only contract between creditors in this case relates directly to the Notes.

U.S. Law

78 Issue was taken by some counsel for parties opposing the Plan with the comments of Justice Ground in *Muscletech* [2007] [14] at paragraph 26, to the effect that third party creditor Releases have been recognized under United States bankruptcy law. I accept the comment of Mr. Woods that the U.S. provisions involve a different statute with different language and therefore different considerations.

79 That does not mean that the U.S. law is to be completely ignored. It is instructive to consideration of the release issue under the CCAA to know that there has been a principled debate within judicial circles in the United States on the issue of releases in a bankruptcy proceeding of those who are not themselves directly parties in bankruptcy.

80 A very comprehensive article authored by Joshua M. Silverstein of Emory University School of Law in 2006, 23 Bank. Dev. J. 13, outlines both the line of U.S. decisions that hold that bankruptcy courts may not use their general equitable powers to modify non-bankruptcy rights, and those that hold that non-bankruptcy law is not an absolute bar to the exercise of equitable powers, particularly with respect to third party releases.

81 The author concludes at paragraph 137 that a decision of the Supreme Court of the United States in *U.S. v. Energy Resources Co.*, 495 U.S. 545 (U.S. Sup. Ct. 1990) offers crucial support for the pro-release position.

82 I do not take any of the statements to referencing U.S. law on this topic as being directly applicable to the case now before this Court, except to say that in resolving a very legitimate debate, it is appropriate to do so in a purposive way

but also very much within a case-specific fact-contextual approach, which seems to be supported by the United States Supreme Court decision above.

Steinberg Decision

83 Against the authorities referred to above, those opposed to the Plan releases rely on the June 16, 1993 decision of the Quebec Court of Appeal in *Steinberg Inc. c. Michaud*[15]

84 Mr. Woods for some of the moving parties urges that the decision, which he asserts makes third party releases illegal, is still good law and binding on this Court, since no other Court of Appeal in Canada has directly considered or derogated from the result. (It appears that the decision has not been reported in English, which may explain some of the absence of comment.)

85 The Applicants not surprisingly take an opposite view. Counsel submits that undoubtedly in direct response to the *Steinberg* decision, Parliament added s. 5.1 (see above paragraph [60]) thereby opening the door for the analysis that has followed with the decisions of *Canadian Airlines, Muscletech* and others. In other words, it is urged the caselaw that has developed in the 15 years since *Steinberg* now provide a basis for recognition of third party releases in appropriate circumstances.

86 The *Steinberg* decision dealt directly with releases proposed for acts of directors. The decision appears to have focused on the nature of the contract created and binding between creditors and the company when the plan is approved. I accept that the effect of a Court-approved CCAA Plan is to impose a contract on creditors.

87 Reliance is placed on the decision of Deschamps J.A. (as she then was) at the following paragraphs of the *Steinberg* decision:

> [54] Even if one can understand the extreme pressure weighing on the creditors and the respondent at the time of the sanctioning, a plan of arrangement is not the appropriate forum to settle disputes other than the claims that are the subject of the arrangement. In other words, one cannot, under the pretext of an absence of formal directives in the Act, transform an arrangement into a potpourri.
>
> [57] If the arrangement is imposed on the dissenting creditors, it means that the rules of civil law founded on consent are set aside, at least with respect to them. One cannot impose on creditors, against their will, consequences that are attached to the rules of contracts that are freely agreed to, like releases and other notions to which clauses 5.3 and 12.6 refer. Consensus corresponds to a reality quite different from that of the majorities provided for in section 6 of the Act and cannot be attributed to dissenting creditors.
>
> [59] Under the Act, the sanctioning judgment is required for the arrangement to bind all the creditors, including those who do not consent to it. The sanctioning cannot have as a consequence to extend the effect of the Act. As the clauses in the arrangement founded on the rules of the Civil Code are foreign to the Act, the sanctioning cannot have any effect on them.
>
> [68] The Act offers the respondent a way to arrive at a compromise with its creditors It does not go so far as to offer an umbrella to all the persons within its orbit by permitting them to shelter themselves from any recourse.
>
> [74] If an arrangement is imposed on a creditor that prevents him from recovering part of his claim by the effect of the Act, he does not necessarily lose the benefit of other statutes that he may wish to invoke. In this sense, if the Civil Code provides a recourse in civil liability against the directors or officers, this right of the creditor cannot be wiped out, against his will, by the inclusion of a release in an arrangement.

88 If it were necessary to do so, I would accept the position of the Applicants that the history of judicial interpretation of the CCAA at both the appellate and trial levels in Canada, along with the change to s. 5.1, leaves the decision in *Steinberg* applicable to a prior era only.

89 I do not think it necessary to go that far, however. One must remember that *Steinberg* dealt with release of claims against directors. As Mme. Justice Deschamps said at paragraph 54, "[A] plan of arrangement is not the appropriate forum to settle disputes other than the claims that are the subject of the arrangement."

90 In this case, all the Noteholders have a common claim, namely to maximize the value obtainable under their notes. The anticipated increase in the value of the notes is directly affected by the risk and contribution that will be made by asset and liquidity providers.

91 In my view, depriving all Noteholders from achieving enhanced value of their notes to permit a few to pursue negligence claims that do not affect note value is quite a different set of circumstances from what was before the Court in *Steinberg*. Different in kind and quality.

92 The sponsoring parties have accepted the policy concern that exempting serious claims such as some frauds could not be regarded as fair and reasonable within the context of the spirit and purpose of the CCAA.

93 The sponsoring parties have worked diligently to respond to that concern and have developed an exemption to the release that in my view fairly balances the rights of Noteholders with serious claims, with the risk to the Plan as a Whole.

Statutory Interpretation of the CCAA

94 Reference was made during argument by counsel to some of the moving parties to rules of statutory interpretation that would suggest that the Court should not go beyond the plain and ordinary words used in the statute.

95 Various of the authorities referred to above emphasize the remedial nature of the legislation, which leaves to the greatest extent possible the stakeholders of the debtor corporation to decide what Plan will or will not be accepted with the scope of the statute.

96 The nature and extent of judicial interpretation and innovation in insolvency matters has been the subject of recent academic and judicial comment.

97 Most recently, Madam Justice Georgina R. Jackson and Dr. Janis Sarra in "Selecting the Judicial Tool to get the Job Done: An Examination of Statutory Interpretation, Discretionary Power and Inherent Jurisdiction in Insolvency Matters," [16] wrote:

> The paper advances the thesis that in addressing the problem of under-inclusive or skeletal legislation, there is a hierarchy or appropriate order of utilization of judicial tools. First, the courts should engage in statutory interpretation to determine the limits of authority, adopting a broad, liberal and purposive interpretation that may reveal the authority. We suggest that it is important that courts first interpret the statute before them and exercise their authority pursuant to the statute, before reaching for other tools in the judicial tool box. Examination of the statutory language and framework of the legislation may reveal a discretion, and statutory interpretation may determine the extent of the discretion or statutory interpretation may reveal a gap. The common law may permit the gap to be filled; if it does, the chambers judge still has a discretion as to whether he or she invokes the authority to fill the gap. The exercise of inherent jurisdiction may fill the gap; if it does, the chambers judge still has a discretion as to whether he or she invokes the authority revealed by the discovery of inherent jurisdiction. This paper considers these issues at some length. [17]

> Second, we suggest that inherent jurisdiction is a misnomer for much of what has occurred in decision making under the CCAA. Appeal court judgments in cases such as *Skeena Cellulose Inc.* and *Stelco* discussed below, have begun to articulate this view. As part of this observation, we suggest that for the most part, the exercise of the court's authority is frequently, although not exclusively, made on the basis of statutory interpretation. [18]
>
> Third, in the context of commercial law, a driving principle of the courts is that they are on a quest to do what makes sense commercially in the context of what is the fairest and most equitable in the circumstances. The establishment of specialized commercial lists or rosters in jurisdictions such as Ontario, Quebec, British Columbia, Alberta and Saskatchewan are aimed at the same goal, creating an expeditious and efficient forum for the fair resolution of commercial disputes effectively and on a timely basis. Similarly, the standards of review applied by appellate courts, in the context of commercial matters, have regard to the specialized expertise of the court of first instance and demonstrate a commitment to effective processes for the resolution of commercial disputes. [19] [cities omitted]

98 The case now before the Court does not involve confiscation of any rights in Notes themselves; rather the opposite: the opportunity in the business circumstances to maximize the value of the Notes. The authors go on to say at p. 45:

> Iacobucci J., writing for the Court in *Rizzo Shoes*, reaffirmed Driedger's Modern Principle as the best approach to interpretation of the legislation and stated that "statutory interpretation cannot be founded on the wording of the legislation alone". He considered the history of the legislation and the benefit-conferring nature of the legislation and examined the purpose and object of the Act, the nature of the legislation and the consequences of a contrary finding, which he labeled an absurd result. Iacobucci J. also relied on s. 10 of the *Interpretation Act*, which provides that every Act "shall be deemed to be remedial" and directs that every Act "shall accordingly receive such fair, large and liberal construction and interpretation as will best ensure the attainment of the object of the Act according to its true intent, meaning and spirit". The Court held:
>
> > 23 Although the Court of Appeal looked to the plain meaning of the specific provisions in question in the present case, with respect, I believe that the court did not pay sufficient attention to the scheme of the ESA, its object or the intention of the legislature; nor was the context of the words in issue appropriately recognized. I now turn to a discussion of these issues.
> >
> > ...
> >
> > 40 As I see the matter, when the express words of ss. 40 and 40a of the ESA are examined in their entire context, there is ample support for the conclusion that the words "terminated by the employer" must be interpreted to include termination resulting from the bankruptcy of the employer. Using the broad and generous approach to interpretation appropriate for benefits-conferring legislation, I believe that these words can reasonably bear that construction.
>
> Thus, in *Rizzo Shoes* we see the Court extending the legislation or making explicit that which was implicit only, as it were, by reference to the Modern Principle, the purpose and object of the Act and the consequences of a contrary result. No reference is made to filling the legislative gap, but rather, the Court is addressing a fact pattern not explicitly contemplated by the legislation and extending the legislation to that fact pattern.
>
> Professor Cote also sees the issue of legislative gaps as part of the discussion of "legislative purpose", which finds expression in the codification of the mischief rule by the various Canadian interpretation statutes. The ability to extend the meaning of the provision finds particular expression when one considers the question posed by him: "can the purposive method make up for lacunae in the legislation". He points out, as does Professor Sullivan, that the courts have not provided a definitive answer, but that for him there are two schools of thought. One draws on the "literal rule" which favours judicial restraint, whereas the other, the "mischief rule", "posits correction of the text to make up for lacunae." To temper the extent of the literal rule, Professor Cote states:

> First, the judge is not legislating by adding what is already implicit. The issue is not the judge's power to actually add terms to a statute, but rather whether a particular concept is sufficiently implicit in the words of an enactment for the judge to allow it to produce effect, and if so, whether there is any principle preventing the judge from making explicit what is already implicit. Parliament is required to be particularly explicit with some types of legislation such as expropriation statutes, for example.
>
> Second, the Literal Rule suggests that as soon as the courts play any creative role in settling a dispute rather than merely administering the law, they assume the duties of Parliament. But by their very nature, judicial functions have a certain creative component. If the law is silent or unclear, the judge is still required to arrive at a decision. In doing so, he [she] may quite possibly be required to define rules which go beyond the written expression of the statute, but which in no way violate its spirit.
>
> In certain situations, the courts may refuse to correct lacunae in legislation. This is not necessarily because of a narrow definition of their role, but rather because general principles of interpretation require the judge, in some areas, to insist on explicit indications of legislative intent. It is common, for example, for judges to refuse to fill in the gaps in a tax statute, a retroactive law, or legislation that severely affects property rights. [Emphasis added. Footnotes omitted.][20]

99 The modern purposive approach is now well established in interpreting CCAA provisions, as the authors note. The phrase more than any other with which issue is taken by the moving parties is that of Paperny J. that s. 5 of the CCAA does not preclude releases other than those specified in s. 5.1.

100 In this analysis, I adopt the purposive language of the authors at pp 55-56:

> It may be that with the increased codification in statutes, courts have lost sight of their general jurisdiction where there is a gap in the statutory language. Where there is a highly codified statute, courts may conclude that there is less room to undertake gap-filling. This is accurate insofar as the Parliament or Legislative Assembly has limited or directed the court's general jurisdiction; there is less likely to be a gap to fill. However, as the Ontario Court of Appeal observed in the above quote, the court has unlimited jurisdiction to decide what is necessary to do justice between the parties except where legislators have provided specifically to the contrary.
>
> The court's role under the CCAA is primarily supervisory and it makes determinations during the process where the parties are unable to agree, in order to facilitate the negotiation process. Thus the role is both procedural and substantive in making rights determinations within the context of an ongoing negotiation process. The court has held that because of the remedial nature of the legislation, the judiciary will exercise its jurisdiction to give effect to the public policy objectives of the statute where the express language is incomplete. The nature of insolvency is highly dynamic and the complexity of firm financial distress means that legal rules, no matter how codified, have not been fashioned to meet every contingency. Unlike rights- based litigation where the court is making determinations about rights and remedies for actions that have already occurred, many insolvency proceedings involve the court making determinations in the context of a dynamic, forward moving process that is seeking an outcome to the debtor's financial distress.
>
> The exercise of a statutory authority requires the statute to be construed. The plain meaning or textualist approach has given way to a search for the object and goals of the statute and the intentionalist approach. This latter approach makes use of the purposive approach and the mischief rule, including its codification under interpretation statutes that every enactment is deemed remedial, and is to be given such fair, large and liberal construction and interpretation as best ensures the attainment of its objects. This latter approach advocates reading the statute as a whole and being mindful of Driedger's "one principle", that the words of the Act are to be read in their entire context, in their grammatical and ordinary sense harmoniously with the scheme of the Act, the object of the Act, and the intention of Parliament. It is important that courts first interpret the statute before them and exercise their authority

> pursuant to the statute, before reaching for other tools in the judicial toolbox. Statutory interpretation using the principles articulated above leaves room for gap-filling in the common law provinces and a consideration of purpose in *Quebec* as a manifestation of the judge's overall task of statutory interpretation. Finally, the jurisprudence in relation to statutory interpretation demonstrates the fluidity inherent in the judge's task in seeking the objects of the statute and the intention of the legislature.

101 I accept the hierarchy suggested by the authors, namely statutory interpretation (which in the case of the CCAA has inherent in it "gap filling"), judicial discretion and thirdly inherent jurisdiction.

102 It simply does not make either commercial, business or practical common sense to say a CCAA plan must inevitably fail because one creditor cannot sue another for a claim that is over and above entitlement in the security that is the subject of the restructuring, and which becomes significantly greater than the value of the security (in this case the Notes) that would be available in bankruptcy. In CCAA situations, factual context is everything. Here, if the moving parties are correct, some creditors would recover much more than others on their security.

103 There may well be many situations in which compromise of some tort claims as between creditors is not directly related to success of the Plan and therefore should not be released; that is not the case here.

104 I have been satisfied the Plan cannot succeed without the compromise. In my view, given the purpose of the statute and the fact that this Plan is accepted by all appearing parties in principle, it is a reasonable gap-filling function to compromise certain claims necessary to complete restructuring by the parties. Those contributing to the Plan are directly related to the value of the notes themselves within the Plan.

105 I adopt the authors' conclusion at p. 94:

> On the authors' reading of the commercial jurisprudence, the problem most often for the court to resolve is that the legislation in question is under-inclusive. It is not ambiguous. It simply does not address the application that is before the court, or in some cases, grants the court the authority to make any order it thinks fit. While there can be no magic formula to address this recurring situation, and indeed no one answer, it appears to the authors that practitioners have available a number of tools to accomplish the same end. In determining the right tool, it may be best to consider the judicial task as if in a hierarchy of judicial tools that may be deployed. The first is examination of the statute, commencing with consideration of the precise wording, the legislative history, the object and purposes of the Act, perhaps a consideration of Driedger's principle of reading the words of the Act in their entire context, in their grammatical and ordinary sense harmoniously with the scheme of the Act, the object of the Act, and the intention of Parliament, and a consideration of the gap-filling power, where applicable. It may very well be that this exercise will reveal that a broad interpretation of the legislation confers the authority on the court to grant the application before it. Only after exhausting this statutory interpretive function should the court consider whether it is appropriate to assert an inherent jurisdiction. Hence, inherent jurisdiction continues to be a valuable tool, but not one that is necessary to utilize in most circumstances.

Fraud Claims

106 I have concluded that claims of fraud do fall into a category distinct from negligence. The concern expressed by the Court in the endorsement of May 16, 2008 resulted in an amendment to the Plan by those supporting it. The Applicants amended the release provisions of the Plan to in effect "carve out" some fraud claims.

107 The concern expressed by those parties opposed to the Plan — that the fraud exemption from the release was not sufficiently broad — resulted in a further hearing on the issue on June 3, 2008. Those opposed continue to object to the amended release provisions.

108 The definition of fraud in a corporate context in the common law of Canada starts with the proposition that it must be made (1) knowingly; (2) without belief in its truth; (3) recklessly, careless whether it be true or false.[21] . It is my

understanding that while expressed somewhat differently, the above-noted ingredients form the basis of fraud claims in the civil law of Quebec, although there are differences.

109 The more serious nature of a civil fraud allegation, as opposed to a negligence allegation, has an effect on the degree of probability required for the plaintiff to succeed. In *Continental Insurance Co. v. Dalton Cartage Co.* [22], Laskin J. wrote:

> There is necessarily a matter of judgment involved in weighing evidence that goes to the burden of proof, and a trial judge is justified in scrutinizing evidence with greater care if there are serious allegations to be established by the proof that is offered. I put the matter in the words used by Lord Denning in *Bater v. Bater, supra*, at p. 459, as follows:
>
> > It is true that by our law there is a higher standard of proof in criminal cases than in civil cases, but this is subject to the qualification that there is no absolute standard in either case. In criminal cases the charge must be proved beyond reasonable doubt, but there may be degrees of proof within that standard. Many great judges have said that, in proportion as the crime is enormous, so ought the proof to be clear. So also in civil cases. The case may be proved by a preponderance of probability, but there may be degrees of probability within that standard. The degree depends on the subject-matter. A civil court, when considering a charge of fraud, will naturally require a higher degree of probability than that which it would require if considering whether negligence were established. It does not adopt so high a degree as a criminal court, even when it is considering a charge of a criminal nature, but still it does require a degree of probability which is commensurate with the occasion.
> >
> > I do not regard such an approach as a departure from a standard of proof based on a balance of probabilities nor as supporting a shifting standard. The question in all civil cases is what evidence with what weight that is accorded to it will move the court to conclude that proof on a balance of probabilities has been established.

110 The distinction between civil fraud and negligence was further explained by Finch J.A. in *Kripps v. Touche Ross & Co.*: [23]

> [101] Whether a representation was made negligently or fraudulently, reliance upon that representation is an issue of fact as to the representee's state of mind. There are cases where the representee may be able to give direct evidence as to what, in fact, induced him to act as he did. Where such evidence is available, its weight is a question for the trier of fact. In many cases however, as the authorities point out, it would be reasonable to expect such evidence to be given, and if it were it might well be suspect as self-serving. This is such a case.
>
> [102] The distinction between cases of negligent and fraudulent misrepresentation is that proof of a dishonest or fraudulent frame of mind on the defendant's part is required in actions of deceit. That, too, is an issue of fact and one which may also, of necessity, fall to be resolved by way of inference. There is, however, nothing in that which touches on the issue of the plaintiff's reliance. I can see no reason why the burden of proving reliance by the plaintiff, and the drawing of inferences with respect to the plaintiff's state of mind, should be any different in cases of negligent misrepresentation than it is in cases of fraud.

111 In *Toronto Dominion Bank v. Leigh Instruments Ltd. (Trustee of)* [24], Winkler J. (as he then was) reviewed the leading common law cases:

> [477] Fraud is the most serious civil tort which can be alleged, and must be both strictly pleaded and strictly proved. The main distinction between the elements of fraudulent misrepresentation and negligent misrepresentation has been touched upon above, namely the dishonest state of mind of the representor. The state of mind was described in the seminal case *Derry v. Peek (1889)*, 14 App. Cas. 337 (H.L.) which held fraud is proved where it is shown that a false representation has been made knowingly, or without belief in its truth, or recklessly, without caring whether it is true or false. The intention to deceive, or reckless disregard for the truth is critical.

[478] Where fraudulent misrepresentation is alleged against a corporation, the intention to deceive must still be strictly proved. Further, in order to attach liability to a corporation for fraud, the fraudulent intent must have been held by an individual person who is either a directing mind of the corporation, or who is acting in the course of their employment through the principle of *respondeat superior* or vicarious liability. In *B. G. Checo v. B. C. Hydro* (1990), 4 C.C.L.T. (2d) 161 at 223 (Aff'd, [1993] 1 S.C.R. 12), Hinkson J.A., writing for the majority, traced the jurisprudence on corporate responsibility in the context of a claim in fraudulent misrepresentation at 222-223:

> Subsequently, in *H.L. Bolton (Engineering) Co. v. T.J Graham & Sons Ltd.*, [1957] 1 Q.B. 159, [1956] 3 All E.R. 624 (C.A.), Denning L.J. said at p. 172:
>
> > A company may in many ways be likened to a human body. It has a brain and nerve centre which controls what it does. It also has hands which hold the tools and act in accordance with directions from the centre. Some of the people in the company are mere servants and agents who are nothing more than hands to do the work and cannot be said to represent the mind or will. Others are directors and managers who represent the directing mind and will of the company, and control what it does. The state of mind of these managers is the state of mind of the company and is treated by the law as such. So you will find that in cases where the law requires personal fault as a condition of liability in tort, the fault of the manager will be the personal fault of the company. That is made clear by Lord Haldane's speech in *Leonard's Carrying Co. Ltd. v. Asiatic Petroleum Co. Ltd.*
>
> It is apparent that the law in Canada dealing with the responsibility of a corporation for the tort of deceit is still evolving. In view of the English decisions and the decision of the Supreme Court of Canada in the *Dredging* case, supra, it would appear that the concept of vicarious responsibility based upon *respondent superior* is too narrow a basis to determine the liability of a corporation. The structure and operations of corporations are becoming more complex. However, the fundamental proposition that the plaintiff must establish an intention to deceive on the part of the defendant still applies.
>
> See also: *Standard Investments Ltd. et al. v. Canadian Imperial Bank of Commerce* (1985), 52 O.R. (2d) 473 (C.A.) (Leave to appeal to Supreme Court of Canada refused Feb. 3, 1986).

[479] In the case of fraudulent misrepresentation, there are circumstances where silence may attract liability. If a material fact which was true at the time a contract was executed becomes false while the contract remains executory, or if a statement believed to be true at the time it was made is discovered to be false, then the representor has a duty to disclose the change in circumstances. The failure to do so may amount to a fraudulent misrepresentation. See: P. Perell, "False Statements" (1996), 18 Advocates' Quarterly 232 at 242.

[480] In *Rainbow Industrial Caterers Ltd. v. Canadian National Railway Co.* (1988), 54 D.L.R. (4th) 43 (B.C.C.A.) (Aff'd on other grounds [1991] 3 S.C.R. 3), the British Columbia Court of Appeal overturned the trial judge's finding of fraud through non-disclosure on the basis that the defendant did not remain silent as to the changed fact but was simply slow to respond to the change and could only be criticized for its "communications arrangements." In so doing, the court adopted the approach to fraud through silence established by the House of Lords in *Brownlie v. Campbell* (1880), 5 App. Cas. 925 at 950. Esson J.A. stated at 67-68:

> There is much emphasis in the plaintiffs submissions and in the reasons of the trial judge on the circumstance that this is not a case of fraud "of the usual kind" involving positive representations of fact but is, rather, one concerned only with non-disclosure by a party which has become aware of an altered set of circumstances. It is, I think, potentially misleading to regard these as different categories of fraud rather than as a different factual basis for a finding of fraud. Where the fraud is alleged to arise from failure

to disclose, the plaintiff remains subject to all of the stringent requirements which the law imposes upon those who allege fraud. The authority relied upon by the trial judge was the speech of Lord Blackburn in *Brownlie v. Campbell*.... The trial judge quoted this excerpt:

> ... when a statement or representation has been made in the bona fide belief that it is true, and the party who has made it afterwards comes to find out that it is untrue, and discovers what he should have said, he can no longer honestly keep up that silence on the subject after that has come to his knowledge, thereby allowing the other party to go on, and still more, inducing him to go on, upon a statement which was honestly made at the time at which it was made, but which he has not now retracted when he has become aware that it can be no long honestly perservered [sic] in.

The relationship between the two bases for fraud appears clearly enough if one reads that passage in the context of the passage which immediately precedes it:

> I quite agree in this, that whenever a man in order to induce a contract says that which is in his knowledge untrue with the intention to mislead the other side, and induce them to enter into the contract, that is downright fraud; in plain English, and Scotch also, it is a downright lie told to induce the other party to act upon it, and it should of course be treated as such. I further agree in this: that when a statement or representation...

[481] Fraud through "active non-disclosure" was considered by the Court of Appeal for Ontario in *Abel v. McDonald*, [1964] 2 O.R. 256 (C.A.) in which the court held at 259: "By active non-disclosure is meant that the defendants, with knowledge that the damage to the premises had occurred actively prevented as far as they could that knowledge from coming to the notice of the appellants.

112 I agree with the comment of Winkler J. in *Toronto Dominion Bank v. Leigh Instruments Ltd. (Trustee of) supra*, that the law in Canada for corporate responsibility for the tort of deceit is evolving. Hence the concern expressed by counsel for Asset Providers that a finding as a result of fraud (an intentional tort) could give rise to claims under the *Negligence Act* to extend to all who may be said to have contributed to the "fault." [25]

113 I understand the reasoning of the Plan supporters for drawing the fraud "carve out" in a narrow fashion. It is to avoid the potential cascade of litigation that they fear would result if a broader "carve out" were to be allowed. Those opposed urged that quite simply to allow the restrictive fraud claim only would be to deprive them of a right at law.

114 The fraud issue was put in simplistic terms during the oral argument on June 3, 2008. Those parties who oppose the restrictions in the amended Release to deal with only some claims of fraud, argue that the amendments are merely cosmetic and are meaningless and would operate to insulate many individuals and corporations who *may* have committed fraud.

115 Mr. Woods, whose clients include some corporations resident in Quebec, submitted that the "carve out," as it has been called, falls short of what would be allowable under the civil law of Quebec as claims of fraud. In addition, he pointed out that under Quebec law, security for costs on a full indemnity basis would not be permitted.

116 I accept the submission of Mr. Woods that while there is similarity, there is no precise equivalence between the civil law of Quebec and the common law of Ontario and other provinces as applied to fraud.

117 Indeed, counsel for other opposing parties complain that the fraud carve out is unduly restrictive of claims of fraud that lie at common law, which their clients should be permitted in fairness to pursue.

118 The particular carve out concern, which is applicable to both the civil and common law jurisdictions, would limit causes of actions to authorized representatives of ABCP dealers. "ABCP dealers" is a defined term within the Plan. Those actions would proceed in the home province of the plaintiffs.

119 The thrust of the Plan opponents' arguments is that as drafted, the permitted fraud claims would preclude recovery in circumstances where senior bank officers who had the requisite fraudulent intent directed sales persons to make statements that the sales persons reasonably believed but that the senior officers knew to be false.

120 That may well be the result of the effect of the Releases as drafted. Assuming that to be the case, I am not satisfied that the Plan should be rejected on the basis that the release covenant for fraud is not as broad as it could be.

121 The Applicants and supporters have responded to the Court's concern that as initially drafted, the initial release provisions would have compromised all fraud claims. I was aware when the further request for release consideration was made that any "carve out" would unlikely be sufficiently broad to include any possibility of all deceit or fraud claims being made in the future.

122 The particular concern was to allow for those claims that might arise from knowingly false representations being made directly to Noteholders, who relied on the fraudulent misrepresentation and suffered damage as a result.

123 The Release as drafted accomplishes that purpose. It does not go as far as to permit all possible fraud claims. I accept the position of the Applicants and supporters that as drafted, the Releases are in the circumstances of this Plan fair and reasonable. I reach this conclusion for the following reasons:

> 1. I am satisfied that the Applicants and supporters will not bring forward a Plan that is as broad in permitting fraud claims as those opposing urge should be permitted.
>
> 2. None of the Plan opponents have brought forward particulars of claims against persons or parties that would fall outside those envisaged within the carve out. Without at least some particulars, expanded fraud claims can only be regarded as hypothetical or speculative.
>
> 3. I understand and accept the position of the Plan supporters that to broaden fraud claim relief does risk extensive complex litigation, the prevention of which is at the heart of the Plan. The likelihood of expanded claims against many parties is most likely if the fraud issue were open-ended.
>
> 4. Those who wish to claim fraud within the Plan can do so in addition to the remedies on the Notes that are available to them and to all other Noteholders. In other words, those Noteholders claiming fraud also obtain the other Plan benefits.

124 Mr. Sternberg on behalf of Hy Bloom did refer to the claims of his clients particularized in the Claim commenced in the Superior Court of Quebec. The Claim particularizes statements attributed to various National Bank representatives both before and after the August 2007 freeze of the Notes. Mr. Sternberg asked rhetorically how could the Court countenance the compromise of what in the future might be found to be fraud perpetrated at the highest levels of the Canadian and foreign banks.

125 The response to Mr. Sternberg and others is that for the moment, what is at issue is a liquidity crisis that affects the ABCP market in Canada. The Applicants and supporters have brought forward a Plan to alleviate and attempt to fix that liquidity crisis.

126 The Plan does in my view represent a reasonable balance between benefit to all Noteholders and enhanced recovery for those who can make out specific claims in fraud.

127 I leave to others the questions of all the underlying causes of the liquidity crisis that prompted the Note freeze in August 2007. If by some chance there is an organized fraudulent scheme, I leave it to others to deal with. At the moment, the Plan as proposed represents the best contract for recovery for the vast majority of Noteholders and hopefully restoration of the ABCP market in Canada.

Hardship

128 As to the hardship issue, the Court was apprised in the course of submissions that the Plan was said by some to act unfairly in respect of certain Noteholders, in particular those who hold Ironstone Series B notes. It was submitted that unlike other trusts for which underlying assets will be pooled to spread risk, the underlying assets of Ironstone Trust are being "siloed" and will bear the same risk as they currently bear.

129 Unfortunately, this will be the case but the result is not due to any particular directive purpose of the Plan itself, but rather because the assets that underlie the trust have been determined to be totally "Ineligible Assets," which apparently have exposure to the U.S. residential sub-prime mortgage market.

130 I have concluded that within the context of the Plan as a whole it does not unfairly treat the Ironstone Noteholders (although their replacement notes may not be worth as much as others'.) The Ironstone Noteholders have still voted by a wide majority in favour of the Plan.

131 Since the Initial Order of March 17, there have been a number of developments (settlements) by parties outside the Plan itself of which the Court was not fully apprised until recently, which were intended to address the issue of hardship to certain investors. These efforts are summarized in paragraphs 10 to 33 of the Eighth Report of the Monitor.

132 I have reviewed the efforts made by various parties supporting the Plan to deal with hardship issues. I am satisfied that they represent a fair and reasonable attempt to deal with issues that result in differential impact among Noteholders. The pleas of certain Noteholders to have their individual concerns addressed have through the Monitor been passed on to those necessary for a response.

133 Counsel for one affected Noteholder, the Avrith family, which opposes the Plan, drew the Court's attention to their particular plight. In response, counsel for National Bank noted the steps it had taken to provide at least some hardship redress.

134 No Plan of this size and complexity could be expected to satisfy all affected by it. The size of the majority who have approved it is testament to its overall fairness. No plan to address a crisis of this magnitude can work perfect equity among all stakeholders.

135 The information available satisfies me that business judgment by a number of supporting parties has been applied to deal with a number of inequities. The Plan cannot provide complete redress to all Noteholders. The parties have addressed the concerns raised. In my view, the Court can ask nothing more.

Conclusion

136 I noted in the endorsement of May 16, 2008 my acceptance and understanding of why the Plan Applicants and sponsors required comprehensive releases of negligence. I was and am satisfied that there would be the third and fourth claims they anticipated if the Plan fails. If negligence claims were not released, any Noteholder who believed that there was value to a tort claim would be entitled to pursue the same. There is no way to anticipate the impact on those who support the Plan. As a result, I accept the Applicants' position that the Plan would be withdrawn if this were to occur.

137 The CCAA has now been accepted as a statute that allows for judicial flexibility to enable business people by the exercise of majority vote to restructure insolvent entities.

138 It would defeat the purpose of the statute if a single creditor could hold a restructuring Plan hostage by insisting on the ability to sue another creditor whose participation in and contribution to the restructuring was essential to its success. Tyranny by a minority to defeat an otherwise fair and reasonable plan is contrary to the spirit of the CCAA.

139 One can only speculate on what response might be made by any one of the significant corporations that are moving parties and now oppose confirmation of this Plan, if any of those entities were undergoing restructuring and had their Plans in jeopardy because a single creditor sought to sue a financing creditor, which required a release as part of its participation.

140 There are a variety of underlying causes for the liquidity crisis that has given rise to this restructuring.

141 The following quotation from the May 23, 2008 issue of The Economist magazine succinctly describes the problem:

> If the crisis were simply about the creditworthiness of underlying assets, that question would be simpler to answer. The problem has been as much about confidence as about money. Modern financial systems contain a mass of amplifiers that multiply the impact of both losses and gains, creating huge uncertainty.

142 The above quote is not directly about the ABCP market in Canada, but about the potential crisis to the worldwide banking system at this time. In my view it is applicable to the ABCP situation at this time. Apart from the Plan itself, there is a need to restore confidence in the financial system in Canada and this Plan is a legitimate use of the CCAA to accomplish that goal.

143 I have as a result addressed a number of questions in order to be satisfied that in the specific context of this case, a Plan that includes third party releases is justified within CCAA jurisdiction. I have concluded that all of the following questions can be answered in the affirmative.

1. Are the parties to be released necessary and essential to the restructuring of the debtor?

2. Are the claims to be released rationally related to the purpose of the Plan and necessary for it?

3. Can the Court be satisfied that without the releases the Plan cannot succeed?

4. Are the parties who will have claims against them released contributing in a tangible and realistic way to the Plan?

5. Is the Plan one that will benefit not only the debtor but creditor Noteholders generally?

6. Have the voting creditors approved the Plan with knowledge of the nature and effect of the releases?

7. Is the Court satisfied that in the circumstances the releases are fair and reasonable in the sense that they are not overly broad and not offensive to public policy?

144 I have concluded on the facts of this Application that the releases sought as part of the Plan, including the language exempting fraud, to be permissible under the CCAA and are fair and reasonable.

145 The motion to approve the Plan of Arrangement sought by the Application is hereby granted on the terms of the draft Order filed and signed.

146 One of the unfortunate aspects of CCAA real time litigation is that it produces a tension between well-represented parties who would not be present if time were not of the essence.

147 Counsel for some of those opposing the Plan complain that they were not consulted by Plan supporters to "negotiate" the release terms. On the other side, Plan supporters note that with the exception of general assertions in the action on behalf of Hy Bloom (who claims negligence as well), there is no articulation by those opposing of against whom claims would be made and the particulars of those claims.

148 It was submitted on behalf of one Plan opponent that the limitation provisions are unduly restrictive and should extend to at least two years from the date a potential plaintiff becomes aware of an Expected Claim.

149 The open-ended claim potential is rejected by the Plan supporters on the basis that what is needed now, since Notes have been frozen for almost one year, is certainty of claims and that those who allege fraud surely have had plenty of opportunity to know the basis of their evidence.

150 Other opponents seek to continue a negotiation with Plan supporters to achieve a resolution with respect to releases satisfactory to each opponent.

151 I recognize that the time for negotiation has been short. The opponents' main opposition to the Plan has been the elimination of negligence claims and the Court has been advised that an appeal on that issue will proceed.

152 I can appreciate the desire for opponents to negotiate for any advantage possible. I can also understand the limitation on the patience of the variety of parties who are Plan supporters, to get on with the Plan or abandon it.

153 I am satisfied that the Plan supporters have listened to some of the concerns of the opponents and have incorporated those concerns to the extent they are willing in the revised release form. I agreed that it is time to move on.

154 I wish to thank all counsel for their cooperation and assistance. There would be no Plan except for the sustained and significant effort of Mr. Crawford and the committee he chairs.

155 This is indeed hopefully a unique situation in which it is necessary to look at larger issues than those affecting those who feel strongly that personal redress should predominate.

156 If I am correct, the CCAA is indeed a vehicle that can adequately balance the issues of all those concerned.

157 The Plan is a business proposal and that includes the releases. The Plan has received overwhelming creditor support. I have concluded that the releases that are part of the Plan are fair and reasonable in all the circumstances.

158 The form of Order that was circulated to the Service List for comment will issue as signed with the release of this decision.

Schedule "A'

Conduits

Apollo Trust

Apsley Trust

Aria Trust

Aurora Trust

Comet Trust

Encore Trust

Gemini Trust

Ironstone Trust

MMAI-I Trust

Newshore Canadian Trust

Opus Trust

Planet Trust

Rocket Trust

Selkirk Funding Trust

Silverstone Trust

Slate Trust

Structured Asset Trust

Structured Investment Trust III

Symphony Trust

Whitehall Trust

Schedule "B"

Applicants

ATB Financial

Caisse de Dépôt et Placement du Québec

Canaccord Capital Corporation

Canada Post Corporation

Credit Union Central of Alberta Limited

Credit Union Central of British Columbia

Credit Union Central of Canada

Credit Union Central of Ontario

Credit Union Central of Saskatchewan

Desjardins Group

Magna International Inc.

National Bank Financial Inc./National Bank of Canada

NAV Canada

Northwater Capital Management Inc.

Public Sector Pension Investment Board

The Governors of the University of Alberta

Application granted.

APPENDIX 1

Parties & Their Counsel

Counsel	*Party Represented*
Benjamin Zarnett Fred Myers Brian Empey	Applicants: Pan-Canadian Investors Committee for Third-Party Structured Asset-Backed Commercial Paper
Donald Milner Graham Phoenix, Xeno C. Martis David Lemieux Robert Girard	Respondents: Metcalfe & Mansfield Alternative Investments II Corp., Metcalfe & Mansfield Alternative Investments III Corp., Metcalfe & Mansfield Alternative Investments V Corp., Metcalfe & Mansfield Alternative Investments XI Corp., Metcalfe & Mansfield Alternative Investments XII Corp.
Aubrey Kauffman Stuart Brotman	Respondents: 4446372 Canada Inc. and 6932819 Canada Inc., as Issuer Trustees
Craig J. Hill Sam P. Rappos Marc Duchesne	Monitor: Ernst & Young Inc.
Jeffrey Carhart Joseph Marin Jay Hoffman	Ad Hoc Committee and PricewaterhouseCoopers Inc., in its capacity as Financial Advisor
Arthur O. Jacques Thomas McRae	Ad Hoc Retail Creditors Committee (Brian Hunter, et al)
Henry Juroviesky Eliezer Karp	Ad Hoc Retail Creditors Committee (Brian Hunter, et al)
Jay A. Swartz Nathasha MacParland	Administrator of Aria Trust, Encore Trust, Newshore Canadian Trust and Symphony Trust
James A. Woods Mathieu Giguere Sébastien Richemont Marie-Anne Paquette	Air Transat A.T. Inc., Transat Tours Canada Inc., The Jean Coutu Group (PJC) Inc., Aéroports de Montreal Inc., Aéroports de Montréal Capital Inc., Pomerleau Ontario Inc., Pomerleau Inc., Labopharm Inc., L'Agence Métropolitaine de Transport (AMT), Domtar Inc., Domtar Pulp and Paper Products Inc., Giro Inc., Vetements de sports RGR Inc., 131519 Canada Inc., Tecsys Inc., New Gold Inc., Services Hypothécaires La Patremoniale Inc. and Jazz Air LLP
Peter F.C. Howard Samaneh Hosseini William Scott	Asset Providers/Liquidity Suppliers: Bank of America, N.A.; Citibank, N.A.; Citibank Canada, in its capacity as Credit Derivative Swap Counterparty and not in any other capacity; Deutsche Bank AG; HSBC Bank Canada; HSBC Bank USA, National Association; Merrill Lynch International; Merrill Lynch Capital Services Inc.; Swiss Re Financial Products Corporation; and UBS AG
George S. Glezos Lisa C. Munro	Becmar Investments Ltd, Dadrex Holdings Inc. and JTI-Macdonald Corp.
Jeremy E. Dacks	Blackrock Financial Management, Inc.
Virginie Gauthier Mario Forte	Caisse de Dépôt et Placement du Québec
Kevin P. McElcheran Malcolm M. Mercer Geoff R. Hall	Canadian Banks: Bank of Montreal, Canadian Imperial Bank of Commerce, Royal Bank of Canada, The Bank of Nova Scotia and The Toronto-Dominion Bank
Harvey Chaiton	Canadian Imperial Bank of Commerce
S. Richard Orzy Jeffrey S. Leon	CIBC Mellon Trust Company, Computershare Trust Company of Canada and BNY Trust Company of Canada, as Indenture Trustees
Margaret L. Waddell	Cinar Corporation, Cinar Productions (2004) and Cookie Jar Animation Inc., ADR Capital Inc. and GMAC Leaseco Corporation
Robin B. Schwill James Rumball	Coventree Capital Inc. and Nereus Financial Inc.
J. Thomas Curry Usman M. Sheikh	Coventree Capital Inc.
Kenneth Kraft	DBRS Limited
David E. Baird, Q.C. Edmond Lamek Ian D. Collins	Desjardins Group
Allan Sternberg Sam R. Sasso	Hy Bloom Inc. and Cardacian Mortgages Services Inc.
Catherine Francis Phillip Bevans	Individual Noteholder
Howard Shapray, Q.C. Stephen Fitterman	Ivanhoe Mines Inc.

Kenneth T. Rosenberg Lily Harmer Massimo Starnino	Jura Energy Corporation, Redcorp Ventures Ltd. and as agent to Ivanhoe Mines Inc.
Joel Vale	I. Mucher Family
John Salmas	Natcan Trust Company, as Note Indenture Trustee
John B. Laskin Scott Bomhof	National Bank Financial Inc. and National Bank of Canada
Robin D. Walker Clifton Prophet Junior Sirivar	NAV Canada
Timothy Pinos	Northern Orion Canada Pampas Ltd.
Murray E. Stieber	Paquette & Associés Huissiers en Justice, s.e.n.c. and André Perron
Susan Grundy	Public Sector Pension Investment Board
Dan Dowdall	Royal Bank of Canada
Thomas N.T. Sutton	Securitus Capital Corp.
Daniel V. MacDonald Andrew Kent	The Bank of Nova Scotia
James H. Grout	The Goldfarb Corporation
Tamara Brooks	The Investment Dealers Association of Canada and the Investment Industry Regulatory Organization of Canada
Sam R. Sasso	Travelers Transportation Services Inc.
Scott A. Turner	WebTech Wireless Inc. and Wynn Capital Corporation Inc.
Peter T. Linder, Q.C. Edward H. Halt, Q.C.	West Energy Ltd., Petrolifera Petroleum Ltd., Vaquero Resources Ltd., UTS Energy Corporation, Nexstar Energy Ltd., Sabre Tooth Energy Ltd., Sabre Energy Ltd., Alliance Pipeline Ltd., Standard Energy Inc. and Power Play Resources Limited
Steven L. Graff	Woods LLP
Gordon Capern Megan E. Shortreed	Xceed Mortgage Corporation

APPENDIX 2

Terms

"*ABCP Conduits*" means, collectively, the trusts that are subject to the Plan, namely the following: Apollo Trust, Apsley Trust, Aria Trust, Aurora Trust, Comet Trust, Encore Trust, Gemini Trust, Ironstone Trust, MMAI-I Trust, Newshore Canadian Trust, Opus Trust, Planet Trust, Rocket Trust, SAT, Selkirk Funding Trust, Silverstone Trust, SIT III, Slate Trust, Symphony Trust and Whitehall Trust, and their respective satellite trusts, where applicable.

"*ABCP Sponsors*" means, collectively, the Sponsors of the ABCP Conduits (and, where applicable, such Sponsors' affiliates) that have issued the Affected ABCP, namely, Coventree Capital Inc., Quanto Financial Corporation, National Bank Financial Inc., Nereus Financial Inc., Newshore Financial Services Inc. and Securitus Capital Corp.

"*Ad Hoc Committee*" means those Noteholders, represented by the law firm of Miller Thomson LLP, who sought funding from the Investors Committee to retain Miller Thomson and PricewaterhouseCoopers Inc., to assist it in starting to form a view on the restructuring. The Investors Committee agreed to fund up to $1 million in fees and facilitated the entering into of confidentiality agreements among Miller Thomson, PwC, the Asset Providers, the Sponsors, JPMorgan and E&Y so that Miller Thomson and PwC, could carry out their mandate. Chairman Crawford met with representatives of Miller Thomson and PwC, and the Committee's advisors answered questions and discussed the proposed restructuring with them.

"*Applicants*" means, collectively, the 17 member institutions of the Investors Committee in their respective capacities as Noteholders.

"*CCAA Parties*" means, collectively, the Issuer Trustees in respect of the Affected ABCP, namely 4446372 Canada Inc., 6932819 Canada Inc., Metcalfe & Mansfield Alternative Investments II Corp., Metcalfe & Mansfield Alternative

Investments III Corp., Metcalfe & Mansfield Alternative Investments V Corp., Metcalfe & Mansfield Alternative Investments XI Corp., Metcalfe & Mansfield Alternative Investments XII Corp. and the ABCP Conduits.

"*Conduit*" means a special purpose entity, typically in the form of a trust, used in an ABCP program that purchases assets and funds these purchases either through term securitizations or through the issuance of commercial paper.

"*Issuer Trustees*" means, collectively, the issuer trustees of each of the ABCP Conduits, namely, 4446372 Canada Inc., 6932819 Canada Inc., Metcalfe & Mansfield Alternative Investments II Corp., Metcalfe & Mansfield Alternative Investments III Corp., Metcalfe & Mansfield Alternative Investments V Corp., Metcalfe & Mansfield Alternative Investments XI Corp. and Metcalfe & Mansfield Alternative Investments XII Corp. and "*Issuer Trustee*" means any one of them. The Issuer Trustees, together with the ABCP Conduits, are sometimes referred to, collectively, as the "*CCAA Parties*".

"*Liquidity Provider*" means like asset providers, dealer banks, commercial banks and other entities often the same as the asset providers who provide liquidity to ABCP, or a party that agreed to provide liquidity funding upon the terms and subject to the conditions of a liquidity agreement in respect of an ABCP program. The Liquidity Providers in respect of the Affected ABCP include, without limitation: ABN AMRO Bank N.V., Canada Branch; Bank of America N.A., Canada Branch; Canadian Imperial Bank of Commerce; Citibank Canada; Citibank, N.A.; Danske Bank A/S; Deutsche Bank AG; HSBC Bank Canada; HSBC Bank USA National Association; Merrill Lynch Capital Services, Inc.; Merrill Lynch International; Royal Bank of Canada; Swiss Re Financial Products Corporation; The Bank of Nova Scotia; The Royal Bank of Scotland plc and UBS AG.

"*Noteholder*" means a holder of Affected ABCP.

"*Sponsors*" means, generally, the entities that initiate the establishment of an ABCP program in respect of a Conduit. Sponsors are effectively management companies for the ABCP program that arrange deals with Asset Providers and capture the excess spread on these transactions. The Sponsor approves the terms of an ABCP program and serves as administrative agent and/or financial services (or securitization) agent for the ABCP program directly or through its affiliates.

"*Traditional Assets*" means those assets held by the ABCP Conduits in non-synthetic securitization structures such as trade receivables, credit card receivables, RMBS and CMBS and investments in CDOs entered into by third-parties.

APPENDIX 3

[Missing text]

Footnotes

1 Information Statement, p. 18

2 Information Statement, p. 18

3 *Canadian Airlines Corp., Re*, [2000] A.J. No. 771, 2000 ABQB 442, [2000] 10 W.W.R. 269, 84 Alta. L.R. (3d) 9, 265 A.R. 201, 9 B.L.R. (3d) 41, 20 C.B.R. (4th) 1, 98 A.C.W.S. (3d) 334 (Alta. Q.B.).

4 *Olympia & York Developments Ltd. v. Royal Trust Co.* (1993), 17 C.B.R. (3d) 1 (Ont. Gen. Div.)

5 *Canadian Red Cross Society / Société Canadienne de la Croix-Rouge, Re*, [1998] O.J. No. 3306, 72 O.T.C. 99, 5 C.B.R. (4th) 299, 81 A.C.W.S. (3d) 932 (Ont. Gen. Div. [Commercial List])

6 *Muscletech Research & Development Inc., Re*, [2006] O.J. No. 4087, 25 C.B.R. (5th) 231, 152 A.C.W.S. (3d) 16, 2006 CarswellOnt 6230 (Ont. S.C.J.)

7 *Muscletech Research & Development Inc., Re*, [2007] O.J. No. 695, 30 C.B.R. (5th) 59, 156 A.C.W.S. (3d) 22, 2007 CarswellOnt 1029 (Ont. S.C.J. [Commercial List])

8 *Vicwest, Re* (Ont. S.C.J. [Commercial List]) per Pepall J. at paragraph 23

9 The Court was provided with copies of 12 Plan approvals under the CCAA in which releases were granted. In various instances these included officers, directors and creditors. The moving parties note that no objection to the nature or extent of release was taken.

10 *NBD Bank, Canada v. Dofasco Inc.*, [1999] O.J. No. 4749, 46 O.R. (3d) 514, 181 D.L.R. (4th) 37, 127 O.A.C. 338, 1 B.L.R. (3d) 1, 15 C.B.R. (4th) 67, 47 C.C.L.T. (2d) 213, 93 A.C.W.S. (3d) 391 (Ont. C.A.)

11 *Stelco Inc., Re*, [2005] O.J. No. 4814, 15 C.B.R. (5th) 297, 143 A.C.W.S. (3d) 623, 2005 CarswellOnt 6483 (Ont. S.C.J. [Commercial List])

12 *Stelco Inc., Re*, [2005] O.J. No. 4883 (Ont. C.A.)

13 *Stelco Inc., Re*, [2007] O.J. No. 2533, 2007 ONCA 483, 226 O.A.C. 72, 32 B.L.R. (4th) 77, 35 C.B.R. (5th) 174, 158 A.C.W.S. (3d) 877, 2007 CarswellOnt 4108 (Ont. C.A.)

14 *Muscletech Research & Development Inc., Re*, 30 C.B.R. (5th) 59, 156 A.C.W.S. (3d) 22, 2007 CarswellOnt 1029 (Ont. S.C.J. [Commercial List])

15 *Steinberg Inc. c. Michaud*, 1993 CanLII 3991, [1993 CarswellQue 229 (Que. C.A.)]

16 Annual Review of Insolvency Law, 2007 Thomson, Carswell. Janis Sarra edition

17 Ibid, p. 42

18 Ibid, pp. 44-45

19 Ibid, p. 45

20 Ibid pp 49-51

21 *Peek v. Derry* (1889), 14 A.C. 337 (U.K. H.L.)

22 *Continental Insurance Co. v. Dalton Cartage Co.*, [1982] 1 S.C.R. 164, 131 D.L.R. (3d) 559 (S.C.C.)

23 *Kripps v. Touche Ross & Co.*, [1997] 6 W.W.R. 421, 89 B.C.A.C. 288 (B.C. C.A.)

24 *Toronto Dominion Bank v. Leigh Instruments Ltd. (Trustee of)* (1998), 40 B.L.R. (2d) 1, 63 O.T.C. 1 (Ont. Gen. Div. [Commercial List]).

25 See *Ecolab Ltd. v. Greenspace Services Ltd.*, [1996] O.J. No. 3528 (Ont. Gen. Div.) per Ground J.

TAB 23

2014 ONSC 5332
Ontario Superior Court of Justice (Divisional Court)

Bongelli v. Ontario (Criminal Injuries Compensation Board)

2014 CarswellOnt 12650, 2014 ONSC 5332, [2014] O.J. No. 4318, 244 A.C.W.S. (3d) 326

Maria Bongelli, Appellant and Criminal Injuries Compensation Board and Gaspare Di Salvo, Respondents

Nordheimer J., Horkins J., D. Brown J.

Heard: September 15, 2014
Judgment: September 15, 2014
Docket: Toronto 349/13

Counsel: Fernando Souza, for Appellant
David E. Fine, for Respondent, Criminal Injuries Compensation Board
Dimple Verma, for Respondent, Gaspare Di Salvo

Subject: Criminal; Public

Headnote

Criminal law --- Victims' rights and third party remedies — Criminal injury compensation boards — Miscellaneous

Criminal Injuries Compensation Board heard application by victim for injuries he sustained at hands of accused — Board sent notice of claim, which asked if accused wished to present evidence at hearing — Accused checked "no" box indicating that she would not be presenting evidence at hearing — Warning beside "no" check box stated that by ticking "no", you agree that Board will not notify you of hearing date, location or time — Victim was awarded compensation — Accused complained that board did not explain to her possible consequence of outcome of hearing on outstanding civil action that victim commenced against accused as result of same matter — Accused appealed, alleging breach of procedural fairness — Appeal dismissed — Accused failed to establish any procedural unfairness in manner in which board proceeded — Board was not obligated to explain impact of outcome of hearing on outstanding civil action — It would not be appropriate for board to provide accused with legal advice regarding other potential proceedings — Notice sent by board was clear in terms of consequences of checking "no" box — There was no suggestion that accused misunderstood that hearing would proceed in her absence.

Table of Authorities

Cases considered by *Nordheimer J.*:

142445 Ontario Ltd. v. I.B.E.W., Local 636 (2009), (sub nom. *142445 Ontario Ltd. v. International Brotherhood of Electrical Workers, Local 636*) 251 O.A.C. 62, 95 Admin. L.R. (4th) 273, 2009 CarswellOnt 2701 (Ont. Div. Ct.) — referred to

APPEAL by accused from decision of Criminal Injuries Compensation Board.

***Nordheimer J.*, (Orally):**

1 Mrs. Bongelli appeals from a decision of the Criminal Injuries Compensation Board that awarded her former son-in-law compensation for injuries he sustained at the hands of Mrs. Bongelli. The appellants' main submission is that the

Board denied her procedural fairness by failing to give her notice of the Board hearing where the evidence was presented that led to the Board's decision.

2 Over the objections of the respondents, we accepted what the parties characterized as "fresh evidence" from the appellant consisting of an affidavit from one of her daughters and thereafter a very late filed affidavit from Mrs. Bongelli. The purpose of the daughter's affidavit was to explain that it was she who had completed the forms for her parents, that I will have more to say about in a moment. Mrs. Bongelli's affidavit served to confirm the contents of the daughter's affidavit. We also accepted an affidavit from an articling student on behalf of Mr. Di Salvo, filed this morning, that attempted to contradict the contents of those affidavits by referencing some excerpts from Mrs. Bongelli's examination for discovery in a separate proceeding.

3 I do not consider any of these affidavits to be properly characterized as fresh evidence. The test in *R. v. Palmer* therefore has no application. Rather, the affidavits address the issue whether there was a failure to accord the appellants procedural fairness at the original hearing and thus a breach of natural justice occurred. As such, the affidavits are presumptively admissible: *142445 Ontario Ltd. v. I.B.E.W., Local 636*, [2009] O.J. No. 2011 (Ont. Div. Ct.). The affidavit goes to the central issue in this appeal and is appropriately received as providing the appellant's explanation for why she did not attend the Board Hearing and thereby provide the framework for her assertion that she was not accorded procedural fairness.

4 That said this appeal cannot be turned into a credibility contest. Consequently, in determining this matter, we have proceeded taking the evidence of Mrs. Bongelli at its best.

5 I should also stress that our acceptance of these affidavits is not intended to condone the very late delivery of all of this material.

6 In terms of the central issue, when the Board receives an application for compensation, the Board sends a Notice of the claim to those persons who, it is alleged, were the "offenders" who caused the injuries. Those individuals are then entitled to file responding material and to attend the hearing of the matter if they wish to do so.

7 It is of importance to note that the Notice that the Board sends out clearly advises the recipient that they are entitled to attend any hearing that is to be held and it explains that, at the hearing, evidence and argument will be presented. The Notice goes on to ask the recipient whether they wish to present evidence at any hearing. There are then two check boxes: one for Yes and one for No. Beside the No check box, there is a warning that reads:

> By ticking "No", you agree that the Board will not notify you of the hearing date, location or time. However, any statements you have written above will be taken into consideration by the adjudicator(s) when rendering a decision in this matter.

8 Both the appellant and her husband returned these Notices with the No box checked off. Notwithstanding that, the appellant now complains that she did not receive notice of the hearing and that, consequently, the Board deprived her of procedural fairness.

9 It is important, in my view, in determining this matter to clearly understand the core complaint of the appellant. It is that she was denied procedural fairness, not because she had always intended to appear at the hearing and misunderstood that she would not be given notice of it. Rather, the asserted procedural fairness is that the Board failed to explain to her what the consequences might be of the outcome of the hearing on an outstanding civil action that her son-in-law commenced against her and her husband as a result of this same matter. In other words, the appellant does not complain that the Board decided to give her former son-in-law some compensation but instead complains that she did not know that, if the Board came to that decision, it might have some adverse impact on the appellant's position in a companion civil proceeding.

10 In my view, the appellant has failed to establish any procedural unfairness in the manner in which the Board proceeded. There was no obligation on the Board to explain what impact, if any, the proceedings of the Board might have on other matters that might be outstanding involving any of the parties before the Board. It is neither the duty of the Board, nor would it be appropriate for the Board, to provide legal advice to the appellant regarding other potential proceedings. The appellant had lawyers acting for her with respect to the civil action and it is to those lawyers that the appellant should have turned for any advice and direction in this matter. Whether she did or did not seek that advice, that is a choice that she made and she must bear the consequences of that choice.

11 The Notice sent by the Board is very clear in terms of the consequences of checking the No box. There is no suggestion in the material before this court that the appellant misunderstood those consequences, that is, that the hearing would proceed in her absence. Rather, her complaint is entirely related to potential ramifications of the Board proceeding on the outstanding civil claim.

12 There is no issue that, at law, the appellant had the right to be given notice of the hearing and to attend the hearing if she had wanted to do so. But at the same time, in the interests of promoting an expedient process, the Board is entitled to adopt a procedure whereby potential parties can waive that right. That is undoubtedly one purpose of the Notice. The Notice also clearly explains the consequence of making that choice.

13 The appellant's position is, in essence, that the Board was required to give her notice of the hearing notwithstanding that the appellant had clearly indicated that she did not want notice of the hearing, all because of unspecified potential impacts on some other separate proceeding. I find that position to be untenable.

14 As a consequence, I can see no merit to the assertion that the Board denied the appellant procedural fairness in proceeding as it did.

15 I also see no merit in the submission that the Board erred in concluding that the events leading to Mr. Di Salvo's injuries did not arise from a crime of violence. On the evidence that was before it, it was open to the Board to conclude that the actions of Mrs. Bongelli constituted an assault that caused serious injuries to Mr. Di Salvo.

16 In light of my conclusion, I do not consider it necessary to address the issue whether this matter was properly raised by way of an appeal from the Board as opposed to by way of an application for judicial review.

17 The appeal is dismissed.

Costs

18 On behalf of the panel, I have endorsed the back of the Appeal Book, "This appeal is dismissed for oral reasons given by Nordheimer J. We do not view this case as an appropriate one to award costs to the Board. We would award costs to Mr. Di Salvo that we fix at $2,500 inclusive of disbursements and HST."

Appeal dismissed.

TAB 24

2002 CarswellOnt 835
Ontario Court of Appeal

Haggith v. 33 Parliament Street Inc.

2002 CarswellOnt 835, 155 O.A.C. 275

MARVIN A. HAGGITH (Plaintiff / Respondent) and 33 PARLIAMENT STREET INC., ROTHBERG KILBRIDE LIMITED, MICHAEL L. KILBRIDE, NORMAN A. ROTHBERG AND HOLLACE WONG (Defendants / Appellants)

Charron, Goudge, Borins JJ.A.

Heard: February 21, 2002
Judgment: February 21, 2002
Oral reasons: February 21, 2002
Written reasons: March 4, 2002
Docket: CA C34645

Proceedings: additional reasons to 2002 CarswellOnt 802 (Ont. S.C.J.); reversing (2000), 10 B.L.R. (3d) 247 (Ont. S.C.J.)

Counsel: *Kirk F. Stevens*, for Appellant
Ronald E. Carr, for Respondent

Subject: Torts

Headnote

Negligence --- General principles — Duty and standard of care — Duty of care

Defendants entered into agreements to purchase two lots of land in order to sell them to limited partnership — Defendants made no inquiries about soil contamination and agreements did not contain terms or conditions relating to risk of soil contamination — Plaintiff purchased unit in limited partnership in August 1988 for $100,000 — Plaintiff was told of soil contamination in December 1989 — Limited partnership units were worthless as of 1992 — Plaintiff brought action for damages for negligence and breach of fiduciary duty against defendants — Action in negligence was allowed — Trial judge found that defendants breached duty of care to potential investors by not obtaining legal advice on issue of risk of soil contamination — Defendants appealed — Appeal allowed — Proximity necessary for duty of care to arise did not exist — Trial judge erred in confining analysis of proximity to consideration of whether harm that occurred could be said to be reasonably foreseeable consequence of defendants' acts — Trial judge was required to examine relationship between plaintiff and defendants — No basis existed upon which to find existence of duty on part of defendants to obtain legal advice about issue of soil contamination or to advise potential investors that they had not done so — All representations made by defendants, including speculative nature of venture were true — Defendants never undertook to provide legal advice relating to transactions and told potential investors to get own legal advice.

Negligence --- General principles — Causation — General

Defendants entered into agreements to purchase two lots of land in order to sell them to limited partnership — Defendants made no inquiries about soil contamination and agreements did not contain terms or conditions relating to risk of soil contamination — Plaintiff purchased unit in limited partnership in August 1988 for $100,000 — Plaintiff was told of soil contamination in December 1989 — Limited partnership units were worthless as of 1992 — Plaintiff brought action for damages for negligence and breach of fiduciary duty against defendants — Action in negligence was allowed — Trial judge found that defendants' failure to obtain legal advice on issue of soil

contamination or to disclose to plaintiff that they had not done so deprived plaintiff of material information and contributed to his decision to invest — Defendants appealed — Appeal allowed — Evidence did not support trial judge's finding that defendants did not disclose that they had not obtained legal advice caused plaintiff to make investment — No evidence existed that had plaintiff known that legal advice had not been obtained he would not have invested — Available evidence suggested that plaintiff would not have been influenced by this knowledge.

Limitation of actions --- Actions in tort — Statutory limitation periods — When statute commences to run — General

Defendants entered into agreements to purchase two lots of land in order to sell them to limited partnership — Defendants made no inquiries about soil contamination and agreements did not contain terms or conditions relating to risk of soil contamination — Plaintiff purchased unit in limited partnership in August 1988 for $100,000 — Plaintiff was told of soil contamination in December 1989 — Limited partnership units were worthless as of 1992 — Plaintiff brought action for damages for negligence and breach of fiduciary duty against defendants — Action in negligence was allowed — Trial judge found that claim was brought within six-year limitation period as time did not begin to run until approximately December 1991 when damages could be reasonably contemplated — Defendants appealed — Appeal allowed — Trial judge erred in failing to find that claim was barred by limitation period — Plaintiff was aware of all elements of cause of action by December 1989 at latest — By then plaintiff knew that no legal advice had been obtained about soil contamination and that agreements did not contain terms or conditions relating to risk of soil contamination — Plaintiff knew that there would be soil clean-up costs which would reduce value of his investment which was sufficient to trigger six-year limitation period — Limitation period expired before claim was issued.

Table of Authorities

Cases considered:

Cooper v. Hobart, 2001 SCC 79, 2001 CarswellBC 2502, 2001 CarswellBC 2503, [2002] 1 W.W.R. 221, 206 D.L.R. (4th) 193, 96 B.C.L.R. (3d) 36, (sub nom. *Cooper v. Registrar of Mortgage Brokers (B.C.)*) 277 N.R. 113, 8 C.C.L.T. (3d) 26 (S.C.C.) — referred to

ADDITIONAL REASONS to judgment, reported at 2002 CarswellOnt 802 (Ont. C.A.), allowing defendants' appeal from judgment, reported at 2000 CarswellOnt 2162, 34 C.E.L.R. (N.S.) 184, 10 B.L.R. (3d) 247 (Ont. S.C.J.), allowing plaintiff's action for damages for negligence.

***The Court*:**

1 The appellants persuaded the respondent to participate with them in a real estate venture involving the purchase of lands. When the venture failed the respondent successfully sued them for negligence. The appeal from that judgment presents three issues.

2 First, the duty of care issue. In our view, the trial judge erred in confining his analysis of proximity to a consideration of whether the harm that occurred could be said to be a reasonably foreseeable consequence of the appellants' acts. As in any negligence case alleging economic loss, he was required to go on even at the first stage of the *Anns* test to examine the relationship between the appellants and the respondent including the factors of expectations, representations if any and reliance. See *Cooper v. Hobart* (2001), [2002] 1 W.W.R. 221 (S.C.C.).

3 Upon examining the relationship between the parties, there is no basis on which to conclude the existence of the duty of care advanced by the respondent, namely the duty to obtain legal advice in connection with the agreement of purchase and sale to address the risk of soil contamination, or alternatively, the duty to advise potential investors that they had not done so. All the representations the appellants did make, including the speculative nature of this venture,

were true. The appellants never undertook to provide legal advice relating to these transactions; to the contrary, they told potential investors to get their own legal advice.

4 In our view, in these circumstances, there was no basis upon which the respondent could have reasonably expected the appellants to be responsible for the legal advice required by the respondent to protect his investment. Hence, the proximity necessary for a duty of care to arise simply does not exist here.

5 Second, the causation issue. The trial judge found that the appellants' failure to obtain legal advice, or to disclose this fact to the respondent, deprived him of material information and thereby contributed to his decision to invest.

6 With respect, we find no support on the record for this finding. The fact that this information might be said to be material is not enough if it cannot be said that its absence caused the investment and subsequent loss. There was simply no evidentiary basis for the latter conclusion. Put another way, there was no evidence that had the respondent known he would not have invested. Indeed, all the available evidence suggests the opposite, namely that he would have been entirely uninfluenced by this knowledge. Hence, if the appellants' failure to obtain legal advice on the purchase or to advise the respondent of this was a breach of duty, it simply cannot be said that it caused the respondent to participate in the investment.

7 Third, the limitations issue. If it could be said that the appellants breached their duty of care to the respondent and that this caused a loss in the sense of a reduction in his investment (as opposed to its complete loss) then it is clear that the respondent was aware of all the elements of his cause of action by December 1989, at the latest. By then he knew of the absence of appropriate terms in the contract of purchase and sale, there having been no legal advice obtained. He also knew there would be some cleanup costs which would reduce the value of his investment. This is sufficient to trigger the six-year limitation period which expired before this claim was issued. Hence the trial judge erred in failing to find this claim to be time barred.

8 In the result the appeal is allowed, the judgment below is set aside and the action is dismissed.

9 Given the factors to be considered (particularly the amount in dispute) and our concern with the overall costs of appellate litigation, we fix the costs of the appeal at $10,000. Costs of the trial are to the appellant on a partial indemnity basis, to be assessed.

Order accordingly.

TAB 25

2002 CarswellOnt 1453
Ontario Superior Court of Justice

Ross v. Christian & Timbers Inc.

2002 CarswellOnt 1453, 113 A.C.W.S. (3d) 759, 18 C.C.E.L. (3d) 165, 18 C.P.C. (5th) 348, 23 B.L.R. (3d) 297

Mark Ross, Plaintiff and Christian and Timbers, Inc., Defendant

Swinton J.

Heard: April 18, 2002
Judgment: April 30, 2002
Docket: 01-CV-220600CM2

Counsel: *J. Gardner Hodder*, for Plaintiff/Responding Party
Christopher Little, for Defendant/Moving Party

Subject: Civil Practice and Procedure; Corporate and Commercial

Headnote

Arbitration --- Submission or agreement to arbitrate — Miscellaneous issues

Before being hired, employee was given offer letter by director of employer's Canadian operations — Offer letter stated that employment would be contingent upon signing of employment agreement which was enclosed — Employee signed offer letter — Employment agreement was not in fact enclosed but drafts were subsequently sent to employee — Employee started work but still had not signed employment agreement — Employment was terminated — Employee brought action for damages for wrongful dismissal — Employer brought motion for stay of proceedings pending disposition in accordance with arbitration clause in employment agreement — Motion granted — Given clear wording of offer letter and employer's regular demands for signed copy of employment agreement, employment was always conditional on signing of employment agreement — Contract of employment incorporated terms of first draft of employment agreement and by terms of that agreement, disputes between parties were to be submitted to arbitration in Ohio — Parties were free to specify which law would govern their agreement — Employee was not being unfairly treated by inclusion of arbitration clause with choice of foreign law in order to undermine his rights — Employee was trained as lawyer and had independent legal advice when he signed offer letter and bargained over its terms — Arbitration agreement was not invalid because it specified Ohio law to govern employment dispute.

Arbitration --- Relation to other proceedings — Stay of court proceedings — General

Before being hired, employee was given offer letter by director of employer's Canadian operations — Offer letter stated that employment would be contingent upon signing of employment agreement which was enclosed — Employee signed offer letter — Employment agreement was not in fact enclosed but drafts were subsequently sent to employee — Employee started work but still had not signed employment agreement — Employment was terminated — Employee brought action for damages for wrongful dismissal — Employer brought motion for stay of proceedings pending disposition in accordance with arbitration clause in employment agreement — Motion granted — Given clear wording of offer letter and employer's regular demands for signed copy of employment agreement, employment was always conditional on signing of employment agreement — Fact that employee began to work without having signed agreement was not waiver of condition by employer — Contract of employment incorporated terms of first draft of employment agreement and by terms of that agreement, disputes between parties were to be submitted to arbitration in Ohio.

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Cases considered by *Swinton J.*:

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Carter v. McLaughlin, 27 O.R. (3d) 792, 1996 CarswellOnt 403 (Ont. Gen. Div.) — considered

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Ruggeberg v. Bancomer S.A., 1999 CarswellOnt 1148, 122 O.A.C. 310 (Ont. C.A.) — referred to

Statutes considered:

Arbitration Act, 1991, S.O. 1991, c. 17
Generally — considered

s. 1 "arbitration agreement" — considered

s. 5(1) — considered

s. 5(2) — considered

s. 7 — considered

s. 7(1) — considered

s. 7(2) — considered

s. 7(2) ¶ 2 — considered

s. 7(2) ¶ 3 — referred to

Courts of Justice Act, R.S.O. 1990, c. C.43
s. 106 — referred to

Employment Standards Act, R.S.O. 1980, c. 137
Generally — referred to

s. 3 — referred to

International Commercial Arbitration Act, R.S.O. 1990, c. I.9
Generally — referred to

s. 13(b) — referred to

Rules considered:

Rules of Civil Procedure, R.R.O. 1990, Reg. 194
R. 21.01(3) — referred to

MOTION by employer for stay of proceedings brought by former employee pending disposition in accordance with arbitration clause in employment agreement.

***Swinton J.*:**

1 The defendant, Christian and Timbers, Inc., has brought a motion for a stay of these proceedings under s. 7 of the *Arbitration Act, 1991*, S.O. 1991, c. 17 and in the alternative, under s. 106 of the *Courts of Justice Act*, R.S.O. 1990, c. C-43 or Rule 21.01(3) of the *Rules of Civil Procedure*.

2 The plaintiff is a former employee of the defendant. Although he trained as a lawyer and practised for three and a half years, he then worked as an executive search consultant for several years. He was hired in that capacity by the defendant in January, 2000. The defendant is in the business of finding and recruiting chief executive officer, board member and senior level executive management personnel for companies. It has its head office in Cleveland, Ohio, although it also has an office in Toronto.

3 Before being hired, Mr. Ross was given a letter of offer dated January 14, 2000 by David Kinley, the managing director of the Canadian operations. It set out various terms of employment. Paragraph 5 is important for purposes of this motion. It stated, in part:

> Employment, and the above considerations, will be contingent upon the signing of an employment agreement and the verification of compensation 'left on the table'. A copy of the employment agreement is enclosed for your review.

In fact, the employment agreement was not enclosed, but a copy was sent to Mr. Ross by January 20, 2000. The next day, Mr. Ross wrote to Mr. Kinley, raising various concerns about the offer letter. He also stated that he had just received the employment agreement and "given its importance to the basis of a relationship going forward, I would ask you that you provide me with the weekend to give it due consideration".

4 There is no dispute that Mr. Ross obtained independent legal advice before he signed the offer letter at a meeting with Mr. Kinley on January 26, 2000. Before the offer letter was signed, one change was made, deleting the condition with respect to satisfactory references. According to Mr. Kinley, no concerns were expressed about the terms of the employment agreement. In cross-examination, he indicated that Mr. Ross said that he was still reviewing the employment agreement. Mr. Ross has claimed that he told Mr. Kinley that he objected to signing the employment agreement at that time.

5 Mr. Ross commenced employment on February 21, 2000. He had still not signed the employment agreement. It is his evidence that he had concerns about the terms of the agreement. However, there is no evidence that he expressed those concerns to Mr. Kinley or to personnel in Cleveland in writing, and Mr. Kinley denies that oral protests were made.

6 About two weeks after Mr. Ross started work, Mr. Kinley was informed by Cleveland that the employment agreement was not signed. He asked Mr. Ross to do so, and Mr. Ross assured him that it had been sent.

7 Cleveland then forwarded what was thought to be another copy of the draft employment agreement, but which now included Mr. Ross's name and was dated February 21, 2000. In fact, it turned out to have a key difference, which was not discovered by the defendant until after these proceedings began. While the original draft had specified a term for the agreement and provisions with respect to termination, this draft provided for employment at will. Otherwise, the draft was virtually the same as the earlier draft. Both included a clause providing for arbitration of disputes, which was to be governed by Ohio law. Mr. Ross claims, in his affidavit, that he noticed the change respecting employment at will and had a real concern, although he did not raise this with Cleveland, according to the defendant. He did not sign this copy.

8 Apparently, further requests were made for a signed copy. Then, in November, 2000, another copy was sent. This, too, had Mr. Ross's name on it, and was dated November 20, 2000, effective February 21, 2000. It now made reference to consideration in the following terms, "in consideration of the mutual covenants contained herein and the sum of One Hundred Dollars ($100.00) delivered to the Vice President and Consultant concurrent with his execution of this Agreement". Paragraph 1 states that both parties understand that they have rights and obligations under the Agreement and "by executing this Agreement, they have exchanged valid consideration". Mr. Ross signed this, although he claims to have done this under duress because of threats of termination or non-payment of his bonus if he did not sign. He never received the $100.00, although there is no evidence that he ever asked for it. According to the defendant, there was no protest raised about the contents of the agreement.

9 On March 19, 2001, Mr. Ross's employment was terminated because of unsatisfactory performance, although cause was not asserted and an offer of payment was made. He then brought an action for wrongful dismissal in Ontario. The defendant seeks to stay this action because of the arbitration clause in the employment agreement. This clause appears in each of the drafts, and provides for arbitration by a member of the American Arbitration Association, in accordance with its Commercial Arbitration Rules, of all disputes arising out of or relating to the agreement or arising out of the employment relationship. The arbitration is to be in Ohio, with the governing law to be that of Ohio. The defendant has invoked this clause and set the arbitration proceedings in motion in Ohio with a Demand for Arbitration in January, 2002. Reference is made in the demand to the November employment agreement.

10 Section 7 of the *Arbitration Act, 1991* provides:

> (1) If a party to an arbitration agreement commences a proceeding in respect of a matter to be submitted to arbitration under the agreement, the court in which the proceeding is commenced shall, on the motion of another party to the arbitration agreement, stay the proceeding.
>
> (2) However, the court may refuse to stay the proceeding in any of the following cases:
>
> 1. A party entered into the arbitration agreement while under a legal incapacity.
>
> 2. The arbitration agreement is invalid.
>
> 3. The subject-matter of the dispute is not capable of being the subject of arbitration under Ontario law.
>
> 4. The motion is brought with undue delay.
>
> 5. The matter is a proper one for default or summary judgement.

An arbitration agreement is defined in s. 1 as "an agreement by which two or more persons agree to submit to arbitration a dispute that has arisen or may arise between them". Pursuant to s. 5(1), an arbitration agreement may be an independent agreement or part of another agreement, and pursuant to s.5(3), it need not be in writing.

11 Initially, the plaintiff took the position that this matter was not governed by the *Arbitration Act, 1991*, but rather the *International Commercial Arbitration Act*, R.S.O. 1990, c. I.9. However, this was not pressed in argument, given the decision in *Carter v. McLaughlin* (1996), 27 O.R. (3d) 792 (Ont. Gen. Div.), in which the Analytical Commentary contained in the Report of the Secretary General to the eighteenth session of the United Nations Commission on International Trade Law was quoted. That document can be used in the interpretation of the Ontario Act (s. 13(b)), and it states that labour or employment disputes were not intended to be covered by the term "commercial" within that Act. A similar conclusion was reached in *Borowski v. Heinrich Fiedler Perforiertechnik GmbH* (1994), 29 C.P.C. (3d) 264 (Alta. Q.B.) at 277 with respect to the inapplicability of the counterpart Alberta legislation to employment disputes.

12 In this motion, the defendant argues that there is an arbitration agreement between the parties, set out in the initial draft copy of the employment contract, to which Mr. Ross was bound when he commenced work on February 21, 2000, given that he had signed the offer letter on January 26, 2000. Essentially, the terms of the agreement were incorporated by reference in his contract, given paragraph 5 of the offer letter which he had signed.

13 The plaintiff argues that the operative agreement should be the November, 2000 agreement which he actually signed, which he argues is invalid, both because of the lack of consideration and because the contract contains an employment at will clause which is contrary to Ontario law. He also asserts that he signed under duress.

14 In order to determine this motion, I must make certain determinations of credibility. This is not easy, given that there are only affidavits and cross-examinations on which to rely. Nevertheless, when I read all the evidence, I find that Mr. Ross's version of events does not seem credible. Mr. Ross takes the position that he protested to Mr. Kinley about the terms of the employment agreement prior to signing the offer letter, and that he expressed his concerns both to Mr. Kinley and Cleveland after that.

15 I find it hard to believe his story that he had real concerns about the terms of the January draft, and that he expressed them. There is nothing in writing to that effect, which is in dramatic contrast to the detailed three page letter which he sent to Mr. Kinley with comments on the offer letter. Moreover, he signed the offer letter, leaving untouched the reference to employment being conditional on the signing of the employment agreement, even though an amendment was made to another part of the letter before signing. There is no evidence of any written complaint to Mr. Kinley or to Cleveland at any time after this, even though he claims to have been troubled by the change in terms from the January draft to the February draft. Finally, it is hard to accept all these assertions from Mr. Ross, given that he is trained as a lawyer. Thus, he is a sophisticated party, and he had independent legal advice before signing the offer. Therefore, I prefer Mr. Kinley's version of events where there is conflict.

16 Section 7 of the *Arbitration Act* makes it clear that the courts are to defer to arbitration, except in the very limited circumstances in s. 7(2), where the court has a discretion whether to defer to arbitration. See *Deluce Holdings Inc. v. Air Canada* (1992), 98 D.L.R. (4th) 509 (Ont. Gen. Div. [Commercial List]) at 525. My first task is to determine whether there is an agreement to arbitrate and, if so, whether it is valid pursuant to s. 7(2) 2. If so, it is clear that the dispute between the parties, arising out of the plaintiff's termination, is the type of dispute which comes within the jurisdiction of the arbitrator in the agreement.

17 In my view, there is no merit to the argument that s. 7(2) 3. is also operative here. That provision allows the court to refuse a stay where the subject matter of the dispute is not capable of being the subject of arbitration under Ontario law. Clearly, the dispute over wrongful dismissal and the appropriate compensation is a subject that can be arbitrated in Ontario, even in a situation where part of the employment agreement may be null and void.

18 The defendant took the position during the argument of the motion that the governing agreement is the January draft, even though it was sent to Mr. Ross through an administrative error and lacked the employment at will term that the employer wanted. The defendant indicates that it will now have to live with the consequences of having sent the

wrong draft if the matter comes before an arbitrator. I accept the defendant's evidence that the January draft was sent to Mr. Ross in error, and that the defendant meant to specify employment at will.

19 The plaintiff argued that the defendant could not rely on that document, since Mr. Ross did not sign it and commenced working without having signed it. Thus, it was argued, the defendant waived the requirement of a signed employment contract. Given the clear wording of the offer letter, and the regular demands of the employer for a signed copy of the employment agreement, I am satisfied that Mr. Ross's employment was always conditional on the signing of an employment contract. The fact that he began to work without having signed one was not, in my view, a waiver of that condition by the defendant. This is evident from the fact that the defendant continued to make efforts for many months to get Mr. Ross to sign the employment contract which he had promised to sign, and which he had in possession prior to commencing work.

20 The issue is whether the January draft was incorporated by reference in his employment contract, despite the lack of a signature. There is *obiter dicta* in *Francis v. Canadian Imperial Bank of Commerce* (1994), 120 D.L.R. (4th) 393 (Ont. C.A.) which supports the defendant's position. There, an employee was presented with an employment contract after commencing employment, never having been alerted to its terms when he signed the offer of employment. The employment agreement was held to be unenforceable because of the absence of new consideration for the alteration of the earlier terms contained in the offer (at 400-402). However, at the end of her reasons, Weiler J.A. observed that in cases such as this,

> employers are able to incorporate the terms of a standard employment agreement into the original contract of employment by saying in their offer of employment that the offer is conditional upon the prospective employee agreeing to accept the terms of the employer's standard form of agreement, a copy of which could be enclosed with the offering letter (at 402-3).

21 Mr. Ross had the draft agreement before signing the offer letter. He made no change to paragraph 5 of the offer, which made his employment conditional on the signing of the employment agreement, and he made no proposals to change the draft. He knew that he was expected to sign it, and I do not accept his story that he gave notice to the defendant that he refused to do so. The defendant takes the position that the contract of employment incorporates the terms of that January draft document, and I accept that argument. Even if the agreement was not signed, acceptance of its terms was a condition of employment, and that acceptance is demonstrated by the commencement of work. By the terms of that agreement, disputes between the parties are to be submitted to arbitration.

22 Originally, as the motion was framed, the defendant relied on the November agreement, and the plaintiff argued that the employment contract was invalid because it expressly contained an employment at will clause. Given the defendant's decision to rely on the January agreement, the plaintiff now argues that the arbitration clause in this agreement is void because Ohio law is governing, and it provides for employment at will. While the plaintiff sought leave to file a late affidavit from an Ohio lawyer describing Ohio law, there was no real contest from the defendant that there is employment at will in Ohio.

23 The Supreme Court of Canada held in *Machtinger v. HOJ Industries Ltd.* (1992), 91 D.L.R. (4th) 491 (S.C.C.) at 505 that terms in a contract of employment in Ontario were invalid because they provided less notice than that to which the employee was entitled under the *Employment Standards Act*. The Court then went on to determine the proper period of notice, concluding that there is an implied term of reasonable notice at common law unless the parties contract out of it by clearly specifying some other period of notice.

24 The plaintiff argued that a term specifying employment at will would contravene the Act with respect to employment in Ontario, since the employee is entitled to a minimum notice period. He then argues that to enforce an arbitration clause, with its submission to Ohio law, will allow an employer to do an end-run around the Ontario legislation. Therefore, he argues that the clause should not be enforced, in order to protect vulnerable employees and vindicate Ontario public policy.

25 Parties often specify the law that will govern their contract. There is nothing contrary to Ontario law in allowing parties to do so in an employment contract such as this, just as they do in commercial settings. See, for example, *Ruggeberg v. Bancomer S.A.*, [1998] O.J. No. 538 (Ont. Gen. Div.), aff'd (1999), 122 O.A.C. 310 (Ont. C.A.). In my view, this is not a case where a vulnerable employee is being unfairly treated by the inclusion of an arbitration clause with a choice of foreign law in order to undermine his rights. Mr. Ross is trained as a lawyer, and he had independent legal advice when he signed the offer letter, and he bargained over its terms. Therefore, I leave for another day whether such clauses may sometimes be unenforceable.

26 It appears to me that the plaintiff wishes to give *Machtinger* a wider application than it is meant to have. In that case, the Supreme Court of Canada held only that the termination provision of the employment contract was null and void, but not the entire contract (at 506). The reason was s. 3 of the Act, which prohibits any contracting out of the employment standards in the Act. However, the Court also held that parties can contract out of the common law rule of termination on reasonable notice if the contract clearly specifies some other period of notice, expressly or by implication (at 503). Here, the January agreement contains termination provisions that must be interpreted.

27 The plaintiff fears that the arbitrator will give effect to the Ohio law of employment at will, and will not give consideration to the illegality of such termination with respect to employment in Ontario. I have no evidence about Ohio conflicts rules with respect to public policy, so I do not know how Ontario law will be treated. However, the parties have agreed that the arbitrator shall determine their disputes in this employment relationship in accordance with Ohio law. In doing so, he or she will also have to interpret their agreement. Thus, it is for the arbitrator to determine the effect of the Ontario law under Ohio law, as well as the appropriate remedy between these parties in light of their agreement.

28 The *Arbitration Act* makes it clear that the courts are to defer to arbitration where the parties have chosen to arbitrate their disputes, except in very limited circumstances. In my view, the arbitration agreement is not invalid because it chooses Ohio law to govern an employment dispute, and, therefore, a stay of this action must be ordered. However, if Mr. Ross's rights under the Ontario legislation are not respected in the arbitration proceedings, he may have further remedies to pursue in Ontario in order to enforce the minimum standards to which he is entitled.

29 Therefore, I order that this action be stayed until the disposition of the arbitration in Ohio. If the parties can not agree with respect to costs, they may make written submissions within 21 days of the release of this decision.

Motion granted.

TAB 26

2014 ABCA 74
Alberta Court of Appeal

Attila Dogan Construction & Installation Co. v. AMEC Americas Ltd.

2014 CarswellAlta 269, 2014 ABCA 74, [2014] A.W.L.D. 1867,
237 A.C.W.S. (3d) 881, 569 A.R. 308, 6 Alta. L.R. (6th) 358

Attila Dogan Construction and Installation Co. Inc., Appellant (Plaintiff/Defendant by Counterclaim) and AMEC Americas Limited, formerly AMEC E&C Services Limited and Agra Moneco Inc., Respondents (Defendants/Plaintiffs by Counterclaim)

Carole Conrad, Ronald Berger, Frans Slatter JJ.A.

Heard: January 13, 2014
Judgment: February 21, 2014 *
Docket: Calgary Appeal 1301-0273-AC

Proceedings: affirming *Attila Dogan Construction & Installation Co. v. AMEC Americas Ltd.* (2013), 2013 CarswellAlta 1979, 2013 ABQB 525, Neil Wittmann C.J.Q.B. (Alta. Q.B.)

Counsel: J.N. Craig, P.D. Banks, D.K. Docheva for Appellant
D.V. Tupper, C. Petrucci for Respondents

Subject: Civil Practice and Procedure; Corporate and Commercial

Headnote

Business associations --- Legal proceedings involving business associations — Practice and procedure in proceedings involving corporations — Pleadings — Amendment

Plaintiff and defendant were parties to joint venture agreement to design and build magnesium oxide plant for J Ltd. — Joint venture agreement was amended to provide that each member would indemnify other members against all losses, damages, costs and expenses — Due to delays, J Ltd. terminated project — Plaintiff commenced action against defendant, and defendant counterclaimed for half of litigation costs — Case management judge partially granted plaintiff's application to amend statement of claim and statement of defence to counterclaim — Judge found that there was no evidence to support claims that plaintiff entered into joint venture amending agreement under duress or undue influence — Judge permitted amendment claiming that plaintiff did not receive certain documents from defendant — Plaintiff appealed — Appeal dismissed — Judge was entitled to take into consideration that plaintiff attempted to add allegation of duress 13 years later — There was no legal basis that any conflict of interest would relieve plaintiff of all its responsibilities to contribute to legitimately incurred litigation costs — There was no palpable and overriding error in assessing evidence or unreasonable exercise of discretion or extricable error of law, and decision was entitled to deference.

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Bank of Boston Connecticut v. European Grain & Shipping Ltd. (1989), [1989] 1 A.C. 1056, [1989] 2 W.L.R. 440 (U.K. H.L.) — referred to

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(sub nom. *Keneric Tractor Sales Ltd. v. Langille)* 43 D.L.R. (4th) 171, (sub nom. *Keneric Tractor Sales Ltd. v. Langille)* 82 N.S.R. (2d) 361, 1987 CarswellNS 390 (S.C.C.) — referred to

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O'Sullivan v. Management Agency (1985), [1985] 3 All E.R. 351, [1985] 1 Q.B. 428 (Eng. C.A.) — referred to

Pao On v. Lau Yiu Long (1979), [1980] A.C. 614, [1979] 3 W.L.R. 435, [1979] 3 All E.R. 65 (Hong Kong P.C.) — referred to

Progress Bulk Carriers Ltd. v. Tube City IMS L.L.C. (2012), [2012] 1 Lloyd's Rep. 501, [2012] EWHC 273 (Eng. & Wales H.C. [T. & C.C.]) — referred to

R. v. Neil (2002), 317 A.R. 73, 284 W.A.C. 73, 168 C.C.C. (3d) 321, 6 Alta. L.R. (4th) 1, 6 C.R. (6th) 1, [2002] 3 S.C.R. 631, 2002 CarswellAlta 1301, 2002 CarswellAlta 1302, 2002 SCC 70, (sub nom. *Neil v. R.)* 218 D.L.R. (4th) 671, [2003] 2 W.W.R. 591, 294 N.R. 201 (S.C.C.) — referred to

Target Holdings Ltd. v. Redferns (1995), [1996] A.C. 421, [1995] 3 All E.R. 785 (Eng. H.L.) — referred to

Rules considered:

Alberta Rules of Court, Alta. Reg. 124/2010
R. 3.62(1)(a) — referred to

R. 3.62(1)(c) — referred to

R. 3.67 — considered

APPEAL by plaintiff from judgment reported at *Attila Dogan Construction & Installation Co. v. AMEC Americas Ltd.* (2013), 2013 ABQB 525, 2013 CarswellAlta 1979, [2013] A.W.L.D. 5437, 234 A.C.W.S. (3d) 602 (Alta. Q.B.), dismissing application to amend pleadings.

Per curiam:

1 The appellant appeals an order of the case management judge, who dismissed an application to amend the appellant's pleadings: *Attila Dogan Construction & Installation Co. v. AMEC Americas Ltd.*, 2013 ABQB 525 (Alta. Q.B.).

Facts

2 The parties were equal participants in a joint venture to design and build a magnesium oxide plant in Jordan for Jordan Magnesia Company. Under the joint venture agreement, dated October 1998, the respondent was to be responsible for detailed engineering, project management, commissioning and start up services, and the appellant was to be responsible for fabrication and construction. Responsibility for other work was shared. The agreement anticipated that each party would provide enough cash to fund its obligations. The appellant, as contractor, anticipated receiving payments from the joint venture as the construction progressed. The agreement also provided:

6.6 Working Capital

(a) Financing and Contributions

To the extent reasonably practicable, the Joint Venture shall obtain any financing required in respect of the Shared Scope of Work from Banks or other lending institutions ...

The agreement went on to provide that if such financing was unavailable or insufficient, the Management Committee could make a cash call on the parties.

3 By December 1999 the project was experiencing difficulties with respect to delays and other issues. The respondent wrote to the appellant on February 2, 2000, enclosing a cash flow projection that confirmed cash deficits over the next 8 months, peaking at $16.3 million in June. Given the need to conserve cash, the respondent advised that "there will be no further payments ... until such time as there is no longer a deficit ...". Estimates of the proposed cash calls were outlined, including $1.34 million from each party by February 22, 2000.

4 The letter went on to propose a solution to "the realities of this working capital deficit" which it acknowledged "may be difficult for your firm to overcome" by making the projected cash advances. The respondent offered to arrange $15 million of financing for up to one year, on the basis that the appellant would provide assurances to the bank for one-half of that amount. Each party would waive claims against the other for delay. After outlining other details, the letter concluded by stating that "failing your agreement" payment of the cash call would be expected by February 22. Nevertheless, during this period advances were made by the joint venture to the appellant in February and April of 2000.

5 The appellant retained counsel, and began to negotiate the terms of a proposed Amending Agreement, which was signed in April 2000. The first draft of the release of delay claims was amended during the negotiations to make it a mutual release. While one of the appellant's principals testified that they had "no alternative" but to renegotiate, he acknowledged the negotiated changes made the agreement fairer:

> Q In the initial draft presented by AMEC, the waiver of claims for delay only ran in favour of AMEC; correct?
>
> A I believe so.
>
> Q And it was then negotiated to be a mutual waiver of claims for delay; correct?
>
> A Well, I mean, this agreement negotiated because of a lot of other reasons where we came to this point, so it ended up in - that we had to negotiate this because there was no other alternative, and it has been negotiated.
>
> Q But there was a negotiation; correct?
>
> A We had no other alternative but to negotiate this agreement.
>
> Q And as a result of negotiation, the one-way waiver of [delay] clause, which we just mentioned, became a mutual waiver of delay claims; correct?
>
> A There has been some changes. So I have to see the first document and the second document.
>
> Q This was viewed, this change, as creating a much fairer clause; correct?
>
> A I'm not sure if it — actually it's a fairer clause; but at the time where we are at, we had no other alternative; so anything that would go better to AD's way, we had to try to take it.

The appellant also negotiated an exclusion of any delay claims by a subsidiary, AD-Demirel Steel Construction and Machine Industry Co. The principal of the appellant later testified that at the time they told the respondent's representatives that the situation was "unfair".

6 In an internal AMEC document, one of the respondent's representatives observed that the appellant had "reluctantly (under duress) agreed to sign this Amendment to the JV Agreement...." The case management judge, however, noted at para. 24 that "while [the representative's] notation in the JorMag Recovery Plan suggests that in his opinion, [the appellant] was a reluctant signatory to the Amending Agreement, it does not appear to be based upon a carefully considered evaluation of the legal basis for a finding of duress."

7 On January 2, 2002 the appellant submitted a delay claim for $28 million which made no reference to the release of those claims in the Amending Agreement, nor any issue of duress. The parties were unable to salvage the project, which was cancelled by Jordan Magnesia Company in July of 2002. The parties then entered into a Claims Agreement, under which they agreed to cooperate and share the expenses of resolving the dispute with Jordan Magnesia Company. The respondent retained counsel on behalf of the joint venture to represent it in the dispute, which eventually went to arbitration. After an interim award was made, the joint venture settled the dispute in 2007 by agreeing to pay $41 million to Jordan Magnesia Company.

8 The appellant issued the present statement of claim in 2007 and amended it in 2010. It alleges various breaches by the respondent in the performance of its design and project management duties under the joint venture agreement, and includes claims related to delay. It also makes claims with respect to the negotiation and outcome of the settlement. The statement of claim pleads that the respondent provided a "false and unrealistic" Project Recovery Plan in 2000, and that as a result of the misrepresentations in that Plan the appellant signed the Amending Agreement. No allegation of duress was made.

9 The respondent defended, partly on the basis that the appellant was the one responsible for the failure of the project. It pleaded that delay claims had been released by the Amending Agreement. It counterclaimed based on the Claims Agreement for the appellant's share of litigation costs in the sum of $11.68 million. The appellant denied liability for the litigation costs on various grounds set out in its defence to counterclaim.

10 The litigation progressed. There have been over 400,000 records produced and over 85 days of questioning. There have been several contested applications, and one prior appeal. In May 2013 the appellant brought an application to further amend its statement of claim and defence to counterclaim. The proposed amendments of the claim include the addition of an allegation that the Amending Agreement was entered into under "duress and/or undue influence":

> AGRA/AMEC attempted to force AD to agree [that it would make no claim for any delay caused by AMEC]. AD entered into this Joint Venture Amending Agreement in circumstances of duress and/or undue influence, the particulars of which include, but are not limited to AD signing this agreement:
>
> (a) at a time when the JV experienced an unexpected cash shortfall of approximately $22 million USD;
>
> (b) following a demand by AMEC requiring that AD either make a cash contribution to the JV of approximately $1.4 million USD or agree to AMEC obtaining external financing in exchange for AD waiving its right to advance any and all claims for delay against AMEC;
>
> (c) following a few months of AMEC unilaterally, without AD's consent or approval, withholding progress payments from AD as a means to force AD to waive its right to claim for delay;
>
> (d) at a time when AMEC knew and understood that AD was not able to make a cash contribution to the JV; and

(e) at a time when AD, to AMEC's knowledge, was vulnerable and with AMEC attempting to force AD to waive its right to claim for delay in exchange for AMEC's promise to obtain financing for the Project.

As a result of the foregoing, the Joint Venture Amending Agreement of April 26, 2000 is invalid and/or unenforceable.

Several other proposed amendments are not an issue on this appeal.

11 The proposed amendment to the defence to counterclaim arose because the appellant had discovered that the law firm retained by the respondent to represent the joint venture in the arbitration had a prior relationship with the respondent. In particular, there was correspondence produced which suggested this firm had supplied advice to the respondent on the interpretation of the joint venture agreement, including how the respondent could respond to claims by the appellant. The proposed amendments allege the respondent was in breach of fiduciary duties by not disclosing that the law firm had a conflict of interest, and as a result the appellant proposed to plead that it was relieved from paying any litigation costs under the Claims Agreement.

Decision of the Case Management Judge

12 While acknowledging that amendments are generously allowed, and only a minimal amount of evidence is needed to support them, the case management judge found that the pleading of economic duress was hopeless. He concluded at para. 24 that four "requirements" for duress had not been met: a) there was no evidence of protest at the time; b) the appellant had negotiated changes and evidence of a lack of alternatives was "inconclusive"; c) the appellant consulted counsel; and d) no steps were taken to set aside the Amending Agreement for 13 years. He summarized at para. 24 that "based on the evidence before me ... the proposed claim for duress is doomed to fail". With respect to the companion claim of undue influence, he found at para. 25 that: "The evidence here indicates that [the appellant], in circumstances of financial stress, entertained a proposal to amend the Joint Venture Agreement, consulted with counsel, proceeded to negotiate, and arrived at an amendment that may, in the long run, not have been in its best interests. There is no evidence of the exercise of domination or control that would support a claim for undue influence."

13 The case management judge found the proposed amendment to the defence to counterclaim lacked particulars. Absent some indication of prejudice or misconduct in the way the arbitration was conducted arising from the alleged conflict of interest, this amendment was also hopeless.

Issues and Standard of Review

14 The appellant argues that the case management judge erred in setting too high an evidentiary standard for amending pleadings, misstated the law on duress and fiduciary duty, and failed to consider the relevant evidence.

15 The standard of review for questions of law is correctness: *Housen v. Nikolaisen*, 2002 SCC 33 (S.C.C.) at para. 8, [2002] 2 S.C.R. 235 (S.C.C.). That standard applies to the case management judge's statement of the law respecting the amendment of pleadings, duress and fiduciary duty.

16 The findings of fact of the trial judge, including those underlying the identified issues of law, will only be reversed on appeal if they disclose palpable and overriding error, even when the chambers judge heard no oral evidence: *Housen* at paras. 19, 24-25; *Andrews v. Coxe*, 2003 ABCA 52 (Alta. C.A.) at para. 16, (2003), 320 A.R. 258 (Alta. C.A.); *Hua v. Optimum West Insurance Co.*, 2005 BCCA 123 (B.C. C.A.) at para. 19, (2005), 209 B.C.A.C. 199, 37 B.C.L.R. (4th) 232 (B.C. C.A.).

17 Absent an error on an extricable question of law, discretionary decisions of case management judges are entitled to deference, and will not be overruled unless they reflect an error of principle or are clearly unreasonable: *Balogun v. Pandher*, 2010 ABCA 40 (Alta. C.A.) at para. 7, (2010), 474 A.R. 258 (Alta. C.A.); *Indian Residential Schools, Re*, 2001 ABCA 216 (Alta. C.A.) at para. 23, (2001), 96 Alta. L.R. (3d) 16, 286 A.R. 307 (Alta. C.A.); *Mikisew Cree First Nation*

v. Canada, 2004 ABCA 279 (Alta. C.A.) at para. 10, (2004), 33 Alta. L.R. (4th) 231, 354 A.R. 365 (Alta. C.A.); *Burtch v. Barnes Estate* (2006), 80 O.R. (3d) 365 (Ont. C.A.) at para. 22, (2006), 27 C.P.C. (6th) 199 (Ont. C.A.); *Bodnar v. Cash Store Inc.*, 2008 BCCA 192 (B.C. C.A. [In Chambers]) at para 10. That includes decisions respecting the amendment of pleadings: *Foda v. Capital Health Region*, 2007 ABCA 207 (Alta. C.A.) at para. 9; *Castledowns Law Office Management Ltd. v. FastTrack Technologies Inc.*, 2012 ABCA 219 (Alta. C.A.) at paras. 14-5, (2012), 75 Alta. L.R. (5th) 125, 533 A.R. 287 (Alta. C.A.).

Economic Duress

18 The test for economic duress in a commercial setting requires a) an illegitimate form of pressure, b) which was sufficient to overcome the will of the protesting party, such that it vitiated any consent or agreement, and c) which caused the entering into of the challenged transaction: *Pao On v. Lau Yiu Long* (1979), [1980] A.C. 614 (Hong Kong P.C.), at pp. 635-6; *Progress Bulk Carriers Ltd. v. Tube City IMS L.L.C.*, [2012] EWHC 273 (Eng. & Wales H.C. [T. & C.C.]) at para. 33, [2012] 1 Lloyd's Rep. 501 (Eng. & Wales H.C. [T. & C.C.])); *Kolmar Group AG v. Traxpo Enterprises PVT Ltd.*, [2010] EWHC 113 (Eng. & Wales H.C. [T. & C.C.])) at para. 92, [2010] 2 Lloyd's Rep. 653 (Eng. & Wales H.C. [T. & C.C.])) (Comm).

19 The applicable principles were outlined in *Kolmar Group* at para. 92:

> Mr. Michael Ashcroft for the claimants submitted, and I agree, that the authorities (summarised in *Goff & Jones, The Law of Restitution* (7[2000] BLR 530 para 131) establish the following principles: th Ed) 10-025 to 10-51 and *Chitty on Contracts* (30th Ed) 7-014 - 7-055; and in *DSND Subsea Ltd v Petroleum Geo Services ASA*
>
> (i) Economic pressure can amount to duress, provided it may be characterised as illegitimate and has constituted a "but for" cause inducing the claimant to enter into the relevant contract or to make a payment. See Mance J in *S.L. Huyton S.A. v Peter Cremer GmbH & Co* [1999] 1 Lloyds Rep. 620;
>
> (ii) a threat to break a contract will generally be regarded as illegitimate, particularly where the defendant must know that it would be in breach of contract if the threat were implemented;
>
> (iii) it is relevant to consider whether the claimant had a "real choice" or "realistic alternative" and could, if it had wished, equally well have resisted the pressure and, for example, pursued practical and effective legal redress. If there was no reasonable alternative, that may be very strong evidence in support of a conclusion that the victim of the duress was in fact influenced by the threat.
>
> (iv) the presence, or absence, of protest, may be of some relevance when considering whether the threat had coercive effect. But, even the total absence of protest does not mean that the payment was voluntary.

This balanced approach to the issues is the appropriate one to take in a case such as this.

20 The presence of duress is often tested by looking for certain indicia or "badges" of duress. The case management judge listed them at para. 22 of his reasons, citing *Ellis v. Friedland*, 2000 ABQB 657 (Alta. Q.B.) at para. 88, (2000), 88 Alta. L.R. (3d) 133 (Alta. Q.B.):

> (a) Whether the party protested at the time the agreement was entered into;
>
> (b) Whether the party had a realistic alternative to entering into the agreement;
>
> (c) Whether the party had the opportunity to speak with independent legal counsel;
>
> (d) Whether, after entering into the agreement, the party took steps to avoid it within a reasonable period of time; and

(e) If a party can show that points (a) to (d) are met, whether the pressure exerted was illegitimate.

The appellant argues that the case management judge erred in law by describing these as "requirements" for duress, as the first four are only evidentiary factors.

21 While it is true that duress might be proven even in the absence of the usual badges, the form of expression chosen by the case management judge does not reflect reviewable error. The case management judge recognized the need for "illegitimate pressure". In considering the combined pleading of "duress and/or undue influence" he concluded at para. 25 that there was insufficient evidence of "domination or control over its will, such that the plaintiff was incapable of independent decision making". Read as a whole, the reasons disclose that he was alive to the proper test.

22 Pressure that is "illegitimate" for the purposes of the law of duress might take many forms. Pressure arising from normal economic factors (such as the effect of "supply and demand") is not sufficient. Nor is it illegitimate for a commercial party to "bargain hard", and advance its own interests. To threaten a breach of contract to obtain further concessions, without any justification, has been recognized as illegitimate: *Kolmar Group* at para. 92. Advising of an impending breach that cannot reasonably be avoided may be justified, and may merely allow the parties to mitigate the inevitable loss. Attempting to renegotiate an agreement in light of changed circumstances, or in pursuit of an accord and satisfaction after a dispute has arisen, will also often be justified. In determining whether pressure is "illegitimate", each case must be assessed on its own facts: *Progress Bulk Carriers* at para. 29.

Amending Pleadings

23 The drafting of pleadings proceeds through three stages:

a) At the commencement of the action the plaintiff is allowed to include any allegation that discloses a cause of action (so long as the pleading is not "vexatious") without having to produce any evidence in support of the pleading.

b) Before "pleadings close" the plaintiff is allowed to amend the pleading "any number of times" without consent or permission, and without having to produce any evidence in support: R. 3.62(1)(a).

c) After "pleadings close" amendments are still possible, but must now be accompanied either by consent or the permission of the court, in which case the amending party will be required to produce some evidence in support of the allegations in the amendment: R. 3.62(1)(c), R. 3.65; *Mikisew Cree First Nation v. Canada*, 2002 ABCA 110 (Alta. C.A.) at paras. 26 ff; (2002), 2 Alta. L.R. (4th) 1, 303 A.R. 43 (Alta. C.A.).

The scheme of the Rules therefore recognizes the importance of "closing pleadings", as defined in R. 3.67. At some point the pleadings must be finalized so as to define the issues in the litigation, and to provide fixed parameters within which record production, questioning, settlement discussions, and the trial can occur.

24 Even after pleadings close, amendments are still relatively easy to get. There is no deadline for amending, and pleadings can even be amended at trial; but that does not mean that the passage of time is irrelevant. Amendments can be allowed even if the original pleading was carelessly prepared, which means that no particular reason for needing the amendment is required. While some evidence is needed to amend after the close of pleadings, the evidentiary threshold is low.

25 The parties agree that the case management judge correctly set out the test for amending pleadings. Assuming some modest amount of evidence is provided in support, any pleading may be amended, no matter how careless or late the party seeking the amendment, subject to four major exceptions:

(a) The amendment would cause serious prejudice to the opposing party, not compensable in costs;

(b) The amendment requested is hopeless;

(c) Unless permitted by statute, the amendment seeks to add a new party or new cause of action after the expiry of a limitation period; or

(d) There is an element of bad faith associated with the failure to plead the amendment in the first instance.

Foda at para. 10; *Dow Chemical Canada Inc. v. Nova Chemicals Corp.*, 2010 ABQB 524 (Alta. Q.B.) at paras. 20-21, (2010), 35 Alta. L.R. (5th) 51, 495 A.R. 338 (Alta. Q.B.).

26 As noted, the amount of evidence required to justify an amendment is low. It is not necessary for the amending party to show that the amended pleading can be proven at trial, nor that it meets the test for summary judgment. In *Balm v. 3512061 Canada Ltd.*, 2003 ABCA 98 (Alta. C.A.) at para. 29, (2003), 14 Alta. L.R. (4th) 221, 327 A.R. 149 (Alta. C.A.) it was said that "a modest degree of evidence justifies an amendment to pleadings". Evidence may be sufficient to support an amendment even if contradictory evidence is presented: *Balm* at para. 15. Even though the test is low, it is not necessarily met by producing "one piece of evidence on each point". However the test is formulated, the decision of the chambers judge as to whether the standard has been met is entitled to deference.

27 Several things might make a proposed amendment "hopeless". That category would include amendments that do not disclose a cause of action. There may be other circumstances where the proposed amendment is so inconsistent with the record that it could fairly be described as "hopeless". Here the case management judge used the expression to indicate that the appellant had not even brought forward enough evidence to meet the low evidentiary threshold required to support an amendment. The use of the term "hopeless" in that context is not an error of law.

The Duress Amendment

28 The appellant argues that the case management judge set too high a standard for the amount of evidence required to support the amendments. It argues that the case management judge effectively engaged in a summary judgment analysis.

29 As noted, the evidentiary standard for amendments is low, but the test does not preclude all weighing of the tendered evidence by the judge. While it is true that the mere presence of contradictory evidence would not necessarily prevent an amendment, it does not follow that merely providing "some evidence" on each point is sufficient. The judge is allowed to engage in some limited assessment of the evidence presented in determining if the threshold necessary to justify amendment has been met.

30 The case management judge disallowed the proposed "duress" amendment. He concluded that there was no evidence of protest at the time, and that the appellant's negotiation of better terms for the Amending Agreement, with the assistance of counsel who would be expected to raise any issues of duress, undermined the appellant's position. He concluded that the respondent's representative's reference to "duress" was not based on an evaluation of the legal basis for a duress claim. The 2002 delay claim was equally consistent with the appellant's pleading of misrepresentations in the Project Recovery Plan. The fact that duress was not raised then or in the initial delay claim was relevant.

31 Duress is a very subjective thing, and one would expect a party who had been forced to sign an agreement under duress would be aware of that immediately, and protest quickly. When attempts are made to add that type of allegation 13 years later, the judge is entitled to take that into consideration in deciding if the amendment is hopeless. The weighing of the evidence here was particularly within the mandate of the case management judge, and his conclusion that the amendment was hopeless does not disclose reviewable error.

32 The appellant also argues that the case management judge misapplied the test for duress. The "illegitimate pressure" was alleged to be the unilateral withholding of progress payments. The record discloses that some progress payments were made, and given the cash flow problems that were identified, nonpayment would not be conclusive evidence of illegitimate conduct. While not specifically pleaded in the proposed amendment, the appellant also argues that it was

"illegitimate" for the respondent to require further concessions from the appellant to get bank financing, when Clause 6.6 of the joint venture agreement required the respondent to arrange that financing.

33 Duress must be assessed in the particular factual context. When the parties entered into the joint venture agreement in 1998, they no doubt anticipated a profitable and mutually beneficial arrangement. By 2000 the joint venture was in trouble, and was under increasing pressure from Jordan Magnesia Company. It is not suggested that the cash flow problem identified in the February 2000 letter was anything but real. In those circumstances, for one party to propose changes to the agreement to reflect the unanticipated events that had emerged does not necessarily amount to duress. Even though the respondent had primary responsibility for arranging financing, the stated requirement in the February letter for each joint venture party to provide assurances to the bank in equal amounts would not offend the covenant. It is also not necessarily improper for one party to point out that a proposed change to the contract (including waiving delay claims) is less undesirable than the alternative (making a cash call).

34 In summary, the assessment of the evidence on duress, and the decision of the case management judge not to exercise his discretion to permit amendments are both entitled to deference on appeal. The appellant has not demonstrated any reviewable error.

The Conflict of Interest Amendment

35 When Jordan Magnesia Company canceled the project, the parties entered into the Claims Agreement. It recited that the litigation of disputes between the parties would be prejudicial to the ability of the joint venture to advance claims against, and defend counterclaims by, Jordan Magnesia Company. The parties agreed to a standstill agreement between themselves, and to cooperate in the dispute with Jordan Magnesia Company. The Claims Agreement was to be neither an admission nor a waiver of any rights between the parties.

36 The Claims Agreement provided that the respondent would retain and pay for outside legal counsel on behalf of the joint venture, and that the appellant would reimburse it for its share of costs. The appellant proposes an amendment that would allege that the counsel ultimately retained had previously provided advice to the respondent, and that accordingly counsel was in a conflict of interest. The proposed amendment recites that the Claims Agreement is therefore "invalid and unenforceable and, accordingly, that all Litigation Costs claimed by [the respondent] pursuant to the Claims Agreement are not recoverable".

37 The appellant did not plead, and cannot now outline how the retained counsel's representation of the joint venture could have been uneven or unfair as between the two joint venture partners. Whatever position counsel advanced at the arbitration accrued equally to the benefit or detriment of both the appellant and the respondent. The denial by this counsel that it represented the appellant was accurate, and did not reflect any breach of duty to the appellant, because in fact that counsel represented the joint venture; that finding is consistent with an earlier ruling of the case management judge: *Attila Dogan Construction and Installation Co. v. AMEC Americas Ltd.*, 2011 ABQB 794 (Alta. Q.B.) at para. 26, (2011), 64 Alta. L.R. (5th) 88, 530 A.R. 264 (Alta. Q.B.).

38 The appellant argues that prejudice is not necessary for a finding of breach of fiduciary duty, relying on cases where a fiduciary has been required to disgorge a profit, even when the beneficiary has suffered no loss. The policy that prevents a fiduciary from keeping such a profit is based partly on deterrence, and differs significantly from the present appeal: *Canson Enterprises Ltd. v. Boughton & Co.*, [1991] 3 S.C.R. 534 (S.C.C.) at p. 579. Permitting a fiduciary in a strictly commercial context like this to recover costs legitimately incurred and that actually benefited the beneficiary, when there is no prejudice or loss to the beneficiary, is qualitatively different: *O'Sullivan v. Management Agency*, [1985] 1 Q.B. 428 (Eng. C.A.).

39 Assuming confidential information was compromised, or fundamentally adverse interests were being represented it is possible that these counsel (who were the ones who should have known the rules) should not have accepted the retainer to represent the joint venture: *R. v. Neil*, 2002 SCC 70, [2002] 3 S.C.R. 631 (S.C.C.). But any breach by counsel

does not necessarily mean there was a secondary breach by the respondent in retaining them, and it is not pleaded that the respondent obtained any benefit connected to the litigation costs from any breach. Even if there was some conflict of interest here, it would not support a remedy unless some damage resulted: *Target Holdings Ltd. v. Redferns* (1995), [1996] A.C. 421 (Eng. H.L.) at p. 440. It is also unclear how any such subsequent breach of duty could have rendered the Claims Agreement previously entered into "invalid and unenforceable" as a subsequent breach does not generally result in the rescission of the contract *ab initio*: *Langille v. Keneric Tractor Sales Ltd.*, [1987] 2 S.C.R. 440 (S.C.C.) at p. 455; *Bank of Boston Connecticut v. European Grain & Shipping Ltd.*, [1989] 2 W.L.R. 440 (U.K. H.L.), at pp. 1098-9. Further, even if this breach would entitle the appellant to a remedy, there is no legal basis for saying that any such conflict of interest would relieve the appellant of all of its responsibilities to contribute to the legitimately incurred litigation costs. The appellant has failed to show how this pleading could be successful.

Conclusion

40 As noted, the assessment of the evidence by the case management judge, and his discretionary decision to refuse these amendments are both entitled to deference. He has been managing this action for several years, and his decision should not be overruled absent some palpable and overriding error in assessing the evidence, an unreasonable exercise of discretion, or an extricable error of law. No such error is disclosed, and the appeal is dismissed.

Appeal dismissed.

Footnotes

* Additional reasons at *Attila Dogan Construction & Installation Co. v. AMEC Americas Ltd.* (2015), 2015 ABCA 9, 2015 CarswellAlta 12 (Alta. C.A.).

End of Document

TAB 27

TAB A

2007 CarswellOnt 1704
Ontario Superior Court of Justice

Ventas Inc. v. Sunrise Senior Living Real Estate Investment Trust

2007 CarswellOnt 1704, [2007] O.J. No. 908, 156 A.C.W.S. (3d) 343, 29 B.L.R. (4th) 292, 56 R.P.R. (4th) 183

Ventas, Inc., 2124678 Ontario Inc., and 2124680 Ontario Inc. (Applicants) and Sunrise Senior Living Real Estate Investment Trust, Sunrise REIT Trust, Sunrise REIT GP, Inc., Sunrise Senior Living Inc., and Health Care Property Investors, Inc. (Respondents)

Sunrise Senior Living Real Estate Investment Trust, Sunrise REIT Trust, and Sunrise REIT GP, Inc. (Applicants) and Ventas SSL Ontario II, Inc. (Formerly 2124678 Ontario Inc.) Ventas SSL Ontario I, Inc. (Formerly 2124680 Ontario Inc.) Ventas, Inc., Sunrise Senior Living, Inc. and Health Care Property Investors Inc. (Respondents)

Sunrise Senior Living, Inc. (Applicant) and Ventas SSL Ontario II, Inc. (Formerly 2124678 Ontario Inc.), Ventas SSL Ontario I, Inc. (Formerly 2124680 Ontario Inc.), Ventas, Inc., Health Care Property Investors, Inc. Sunrise Senior Living Real Estate Investment Trust, Sunrise REIT Trust and Sunrise REIT GP, Inc. (Respondents)

Pepall J.

Judgment: March 6, 2007 *
Docket: 07-CL-6893

Proceedings: affirmed *Ventas Inc. v. Sunrise Senior Living Real Estate Investment Trust* (2007), 2007 CarswellOnt 1705, B.L.R. 29 (4th) 312 (Ont. C.A.)

Counsel: Mark A. Gelowitz, Laura K. Fric for Applicants, Ventas Inc., 2124678 Ontario Inc., 2124680 Ontario Inc.
Mark A. Gelowitz, Laura K. Fric for Respondents, Ventas SSL Ontario II, Inc. (Formerly 2124678 Ontario Inc.), Ventas SSL Ontario I., Inc. (Formerly 2124680 Ontario Inc.) and Ventas, Inc.
Peter F.C. Howard, Eliot Kolers, Ellen Snow for Respondents / Applicants, Sunrise Senior Living Real Estate Investment Trust, Sunrise REIT Trust, Sunrise REIT GP Inc.
Luis Sarabia, Cynthia Spry for Respondent / Applicant, Sunrise Senior Living, Inc.
Robert W. Staley, Derek J. Bell, Lisa Millman for Respondent, Health Care Property Investors Inc.

Subject: Corporate and Commercial; Contracts; Property; Public

Headnote

Business associations --- Powers, rights and liabilities — Contracts by corporations — Miscellaneous issues

Real estate trust was publicly traded entity — Board established special committee to explore possibility of sale of trust units or assets through confidential sale process — All parties interested in purchase of trust assets were required to enter into confidentiality agreement with trust — Trust entered into confidentiality agreements with American-based corporation and third party — Confidentiality agreements contained standstill terms prohibiting contact between either potential purchaser and trust's subsidiary — Corporation entered into agreement with trust to purchase assets — Third party learned of agreement and sent last-ditch proposal to trust — Trust told third party to enter discussions with representatives from subsidiary — Corporation refused to waive standstill terms of agreement — Corporation brought application for declaration that trust was obligated to enforce standstill terms in confidentiality agreement — Application granted — Trust expressly and unambiguously agreed that it would not amend, waive or fail to enforce any of standstill terms or other conditions included in confidentiality agreements

without waiver of corporation — Third party was in clear breach of standstill terms and trust was obligated to enforce such breach — Parties to transaction were experienced and sophisticated with financial advisors and legal representation from prominent firms — Role of courts was not to rewrite contracts entered into by sophisticated commercial parties.

Table of Authorities

Cases considered by *Pepall J.*:

BG Checo International Ltd. v. British Columbia Hydro & Power Authority (1993), 1993 CarswellBC 1254, [1993] 2 W.W.R. 321, [1993] 1 S.C.R. 12, 147 N.R. 81, 75 B.C.L.R. (2d) 145, 99 D.L.R. (4th) 577, 20 B.C.A.C. 241, 35 W.A.C. 241, 14 C.C.L.T. (2d) 233, 5 C.L.R. (2d) 173, 1993 CarswellBC 10 (S.C.C.) — considered

Eli Lilly & Co. v. Novopharm Ltd. (1998), 227 N.R. 201, 152 F.T.R. 160 (note), 1998 CarswellNat 1061, 1998 CarswellNat 1062, 161 D.L.R. (4th) 1, [1998] 2 S.C.R. 129, 80 C.P.R. (3d) 321 (S.C.C.) — followed

Kentucky Fried Chicken Canada v. Scott's Food Services Inc. (1998), 1998 CarswellOnt 4170, 41 B.L.R. (2d) 42, 114 O.A.C. 357 (Ont. C.A.) — followed

Lee v. Canada (Minister of Citizenship & Immigration) (1997), 37 Imm. L.R. (2d) 278, 1997 CarswellNat 338, 126 F.T.R. 229 (Fed. T.D.) — referred to

Scanlon v. Castlepoint Development Corp. (1992), 29 R.P.R. (2d) 60, 59 O.A.C. 191, 11 O.R. (3d) 744, 99 D.L.R. (4th) 153, 1992 CarswellOnt 633 (Ont. C.A.) — considered

Solosky v. Canada (1979), 1979 CarswellNat 4, (sub nom. *Solosky v. R.*) [1980] 1 S.C.R. 821, 105 D.L.R. (3d) 745, 16 C.R. (3d) 294, 30 N.R. 380, 50 C.C.C. (2d) 495, 1979 CarswellNat 630 (S.C.C.) — referred to

Toronto Dominion Bank v. Leigh Instruments Ltd. (Trustee of) (1998), 1998 CarswellOnt 2565, 40 B.L.R. (2d) 1 (Ont. Gen. Div. [Commercial List]) — followed

Toronto Dominion Bank v. Leigh Instruments Ltd. (Trustee of) (1999), 45 O.R. (3d) 417, (sub nom. *Toronto-Dominion Bank v. Leigh Instruments Ltd. (Bankrupt)*) 124 O.A.C. 87, 178 D.L.R. (4th) 634, 50 B.L.R. (2d) 64, 1999 CarswellOnt 2812 (Ont. C.A.) — referred to

Venture Capital USA Inc. v. Yorkton Securities Inc. (2005), 2005 CarswellOnt 1875, 197 O.A.C. 264, 75 O.R. (3d) 325, 4 B.L.R. (4th) 324 (Ont. C.A.) — followed

APPLICATION by corporation for declaration that trust was obligated to enforce confidentiality agreement.

***Pepall J.*:**

Introduction

1 This case involves the interpretation of a purchase agreement entered into following an auction. The issue to be considered is whether the vendor has an obligation under that agreement to enforce a standstill agreement signed by an unsuccessful auction participant.

Facts

2 Sunrise Senior Living Real Estate Investment Trust ("Sunrise REIT") is a Canadian public real estate investment trust whose units are listed on the Toronto Stock Exchange. It owns and invests in income producing and newly developed senior living communities in major metropolitan markets and surrounding suburban areas in Canada and the United States. It owns 74 senior living communities all of which are managed by Sunrise Senior Living, Inc. ("SSL"). SSL is one of the largest providers of such management services in North America. It is an American public company whose shares are listed on the New York Stock Exchange.

3 In September, 2006, the Board of Trustees of Sunrise REIT determined that a strategic sale process of the investment trust would likely be beneficial for unitholders. The Board decided to explore the possibility of a sale of either the Sunrise REIT units or assets of Sunrise REIT through a confidential sale process. It established a special committee to examine alternative transactions and the committee in turn engaged TD Securities as its financial advisor. Mr. Warren, the chairman of the Board of Sunrise REIT, testified that he sought to move the REIT towards value maximization through the process of an auction and that he retained TD Securities to assist in creating an auction designed to encourage bidders to make their best offer. Sunrise REIT initiated a strategic review process. As part of the first round of this process, TD Securities approached a select number of prospective purchasers regarding their interest in purchasing all of the Sunrise REIT units or all of Sunrise REIT's assets.

4 Interested parties were each required to enter into a confidentiality agreement. Sunrise REIT entered into seven confidentiality agreements, three of which were with parties to these applications, namely SSL, Ventas Inc. ("Ventas") and Health Care Property Investors, Inc. ("HCP"). Ventas is an American public company whose shares are listed on the New York Stock Exchange. It is a leading health care real estate investment trust which owns a number of properties including independent and assisted living facilities, skilled nursing facilities, hospitals and medical office buildings. HCP is also an American public company whose shares are also listed on the New York Stock Exchange. It is a self-administered investment trust that invests directly or through joint ventures in health care facilities. Ventas and Sunrise REIT executed a confidentiality agreement dated November 7, 2006, HCP and Sunrise REIT entered into a confidentiality agreement on November 8, 2006 and on November 10, 2006, Sunrise REIT and SSL also executed a confidentiality agreement.

5 With one exception, the confidentiality agreements of HCP and Ventas were substantially similar. The agreements imposed restrictions on the use and disclosure of confidential non-public proprietary information provided by Sunrise REIT to the potential purchaser and contained further terms prohibiting communications between the potential purchaser and SSL without the prior written consent of Sunrise REIT. The agreements also prevented a potential purchaser from visiting any facility managed by SSL regardless of whether it was owned by Sunrise REIT. The agreements provided for access by the potential purchaser to a detailed online data room containing additional confidential information of Sunrise REIT. The confidentiality agreements provided that to facilitate discussion relating to a potential negotiated transaction, Sunrise REIT expected to make certain non-public information available. Specifically, the parties to the confidentiality agreements agreed that,

> Moreover, without the prior written consent of Sunrise REIT, the Interested Party [1] will not, and will direct its Representatives not to, directly or indirectly (a) disclose to Sunrise Senior Living, Inc. ("Sunrise") that it has entered into this agreement or entered into discussions with Sunrise REIT relating to the Transaction, (b) approach or contact or discuss with Sunrise to discuss any terms or other facts with respect to the Transaction, the Evaluation Material or any information regarding the business, financial condition, operations, assets, properties, liabilities, or prospects of Sunrise REIT, including any information regarding any properties managed by Sunrise, or (c) visit any property or facility managed by Sunrise, whether owned by Sunrise REIT or otherwise.

The confidentiality agreements addressed waiver as follows,

> No provision of this agreement can be waived except by means of a written instrument that is validly executed on behalf of the party hereto granting the waiver and that refers specifically to the particular provision or provisions

> being waived. No failure or delay by a party hereto in exercising any right hereunder or any partial exercise thereof will operate as a waiver thereof or preclude any other or further exercise of any right hereunder.

Both HCP and Ventas had standstill provisions in their confidentiality agreements but their language differed. Amongst other things, HCP agreed that for a period of 18 months it would not make a proposal to acquire any securities or assets of Sunrise REIT unless it had Sunrise REIT's prior written consent. More precisely, the HCP confidentiality agreement provided that,

> In consideration of the Evaluation Material being furnished to the Interested Party [HCP], the Interested Party agrees that from the date hereof until the date that is 18 months from the date hereof (the "Standstill Period"), without the prior written consent of Sunrise REIT, the Interested Party shall not and shall cause its affiliates not to: (a) in any manner acquire, agree to acquire or make any proposal to acquire, directly or indirectly, by means of purchase, merger, business combination or in any other manner, beneficial ownership of any securities or all or any assets of Sunrise REIT or any of its subsidiaries, (b) make, or in any way participate, directly or indirectly, in any solicitation of proxies to vote, or seek to advise or influence any person with respect to the voting of, any voting securities of Sunrise REIT, (c) form, join or in any way participate in a "group" (within the meaning of Section 13(d)(3) of the *United States Securities Exchange Act* of 1934) or act jointly or in concert with any other person with respect to any voting securities of Sunrise REIT, (d) otherwise act, alone or in concert with others, to seek to control, advise, change or influence the management, board of trustees, or governing instruments of Sunrise REIT, (e) make any public disclosure of any intention in connection with the foregoing, (f) make any public disclosure, or take any action that could require Sunrise REIT to make any public disclosure, with respect to any of the matters set forth in this agreement, (g) disclose any intention, plan or arrangement inconsistent with the foregoing, or (h) advise, assist or encourage any other persons in connection with any of the foregoing. The Interested Party also agrees during such period not to request Sunrise REIT or any of its Representatives, directly or indirectly, to amend or waive any provision of this paragraph (including this sentence).(emphasis added)

For ease of reference, this provision is referred to in these reasons as the Standstill Agreement.

6 The Ventas confidentiality agreement contained a similar standstill provision but it ceased to apply if, amongst other things, Sunrise REIT entered into an agreement to sell more than 20% of its units or assets to a third party. Items (a) through and including (h) and following were identical to the provisions of HCP's agreement but the definition of Ventas' Standstill Period differed from that of HCP as follows:

> In consideration of the mutual agreements contained herein and the provisions of the Evaluation Material to the Interested party [Ventas], the parties hereto agree that until the earlier of (i) the expiration of 18 months from the date hereof, (ii) such date, if any, that Sunrise REIT or any of its affiliates has entered into or publicly disclosed its intent to enter into a definitive agreement with the Interested Party or any of its affiliates or any third party with respect to any sale of Sunrise REIT, a sale or other divestiture in a single or series of related transactions of more than 20% of Sunrise REIT's equity securities, assets or operations, or any other transaction that would reasonably be expected to result in a change of control of Sunrise REIT, or (iii) such date, if any, that is fifteen business days following the date any third party has formally commenced an unsolicited take-over bid, tender offer or exchange offer for any of Sunrise REIT's securities which has not been publicly rejected by Sunrise REIT's board (such period described in the preceding clauses (i) through (iii), the "Standstill Period").

Ventas was unaware of the terms of the HCP confidentiality agreement until February 18, 2007.

7 Having executed confidentiality agreements, potential purchasers were then invited to make a preliminary non-binding written proposal. Following a review of the preliminary proposals submitted in December, 2006, the Sunrise REIT special committee invited a number of interested bidders to go to round two, in effect to undertake further due diligence and to submit a final bid in January, 2007.

8 By early December 2006, it became clear to the special committee that SSL was not an interested purchaser and therefore, there was no longer any need to maintain the prohibition on discussions with SSL as set forth in the confidentiality agreements. Sunrise REIT therefore authorized TD Securities to contact HCP and Ventas and to arrange for them to have direct contact with SSL which they did.

9 Ventas and HCP were the only participants invited to the second stage of the auction. Both were asked to submit a final binding proposal for the acquisition of Sunrise REIT by January 8, 2007. In the correspondence sent to HCP, it was told, "You should not assume that you will be given an opportunity to rebid, renegotiate, or improve the terms of your proposal." Ventas submitted its proposal but HCP withdrew from the process and declined to submit a final binding proposal on the basis that it was unable to successfully negotiate an agreement with SSL. The special committee endorsed the Ventas proposal and the Board subsequently met and voted to approve the Ventas transaction and to recommend it to the Sunrise REIT unitholders.

10 Following the Board approval, Ventas and Sunrise REIT entered into a purchase agreement (the "Purchase Agreement") on January 14, 2007. Concurrently, Ventas also entered into an agreement with SSL. The next day Sunrise REIT publicly announced the Ventas transaction.

11 Under the terms of the Purchase Agreement, through two wholly owned subsidiaries, 2124678 Ontario Inc. and 2124680 Ontario Inc., Ventas was to acquire substantially all of Sunrise REIT's assets as well as assume substantially all of its liabilities for a cash consideration of $15 per Sunrise REIT unit. According to Sunrise REIT's press release of January 15, 2007, this represented a 35.7% premium over the closing price of the units on January 12, 2007. The Ventas transaction must be approved by Sunrise REIT unitholders at a special meeting of all unitholders. The meeting is to take place before March 31, 2007. If the unitholders reject the offer, the Purchase Agreement may be terminated by Sunrise REIT.

12 The Purchase Agreement contained an entire agreement provision which states,

> This Agreement, the agreements and other documents herein referred to and the Confidentiality Agreement constitute the entire agreement between the parties pertaining hereto and supersede all other prior agreements, understandings, negotiations and discussions, whether oral or written, between the parties hereto. Except as expressly represented and warranted herein, neither party shall be considered to have given any other express or implied representations or warranties, including without limitation as a result of oral or written statements.

The purchase price was stated to be equal to the amount of $1,137,712,410 plus assumed liabilities. In Section 2.5 of the Purchase Agreement, Sunrise REIT waived the standstill provisions contained in the Ventas confidentiality agreement and stated that in all other respects, the provisions of the Ventas confidentiality agreement continued to apply.

13 Article 4 of the Purchase Agreement addressed covenants and 4.4 was entitled "Covenants Regarding Non-Solicitation". Given their significance to this dispute, these provisions are reproduced in their entirety as follows:

> 4.4 (1) Following the date hereof, Sunrise REIT shall not, directly or indirectly, through any trustee, officer, director, agent or Representative of Sunrise REIT or any of its Subsidiaries, and shall not permit any such Person to,
>
> (i) solicit, initiate, encourage or otherwise facilitate (including by way of furnishing information or entering into any form of agreement, arrangement or understanding or providing any other form of assistance) the initiation of any inquiries or proposals regarding, or other action that constitutes, or may reasonably be expected to lead to, an actual or potential Acquisition Proposal,
>
> (ii) participate in any discussions or negotiations in furtherance of such inquiries or proposals or regarding an actual or potential Acquisition Proposal or release any Person from, or fail to enforce, any confidentiality or standstill agreement or similar obligations to Sunrise REIT or any of its Subsidiaries, (emphasis added)

(iii) approve, recommend or remain neutral with respect to, or propose publicly to approve, recommend or remain neutral with respect to, any Acquisition Proposal,

(iv) accept or enter into any agreement, arrangement or understanding related to any Acquisition Proposal (other than a confidentiality agreement contemplated in Section 4.4(2)), or

(v) withdraw, modify or qualify, or publicly propose to withdraw, modify or qualify, in any manner adverse to the Purchasers, the approval or recommendation of the Board (including any committee thereof) of this Agreement or the transactions contemplated hereby.

(2) Notwithstanding anything contained in Section 4.4(1), until the Unitholder Approval, nothing shall prevent the Board from complying with Sunrise REIT's disclosure obligations under applicable Laws with regard to a bona fide written, unsolicited Acquisition Proposal or, following the receipt of any such Acquisition Proposal from a third party (that did not result from a breach of this Section 4.4), from furnishing or disclosing non-public information to such Person if and only to the extent that:

(i) the Board believes in good faith (after consultation with its financial advisor and legal counsel) that such Acquisition Proposal if consummated could reasonably be expected to result in a Superior Proposal; and

(ii) such third party has entered into a confidentiality agreement containing terms in the aggregate no more favourable to such third party than those in the Confidentiality Agreement as are then in effect in accordance with its terms.

(3) Notwithstanding anything contained in Section 4.4(1), until the Unitholder Approval, nothing shall prevent the Board from withdrawing or modifying, or proposing publicly to withdraw or modify its approval and recommendation of the transactions contemplated by this Agreement, or accepting, approving or recommending or entering into any agreement, understanding or arrangement providing for a bona fide written, unsolicited Acquisition Proposal (that did not result from a breach of this Section 4.4) ("Proposed Agreement") if and only to the extent that:

(i) it has provided the Purchasers with a copy of all of the documents relating to the Acquisition Proposal,

(ii) the Board, believes in good faith (after consultation with its financial advisor and legal counsel) that such Acquisition Proposal constitutes a Superior Proposal and has promptly notified the Purchasers of such determination,

(iii) a period of at least five Business Days (the "Matching Period") has elapsed following the later of (x) the date the Purchasers received written notice advising the Purchasers that the Board has resolved, subject to compliance with this Section 4.4(3), to withdraw, modify its approval and recommendation of the transactions contemplated by this Agreement or accept, approve or recommend or enter into a Proposed Agreement in respect of such Superior Proposal and (y) the date the Purchasers received a copy of the documentation related to such Superior Proposal pursuant to Section 4.4(3)(i),

(iv) if the Purchasers have proposed to amend the transactions contemplated under this Agreement in accordance with Section 4.4(6), the Board has again made the determination in Section 4.4(3)(ii) taking into account such proposed amendments; and

(v) if Sunrise REIT proposes to enter into a Proposed Agreement (other than a confidentiality agreement referred to in Section 4.4(2)) after complying with this Section 4.4(3), Sunrise REIT shall have complied with Section 5.2 and 5.3. For the purposes of this Section 4.4(3) the preparation and delivery of a directors' circular pursuant to Section 99 of the *Securities Act* relating to an Acquisition Proposal shall be deemed to be a qualification, withdrawal or modification, of the Board's recommendation of the transactions contemplated

hereby unless the Board expressly, and without qualification, reaffirms its recommendation of the transactions contemplated hereby in such disclosure.

(4) If the expiry of the Matching Period referred to in Section 4.4(3)(iii) falls on a date which is less than five Business Days prior to the Unitholder Meeting, Sunrise REIT shall, at the request of the Purchasers, adjourn the Unitholder Meeting to a date that is not more than 10 Business Days following such expiry date.

(5) Sunrise REIT acknowledges and agrees that each successive amendment to any Acquisition Proposal shall constitute a new Acquisition Proposal for purposes of Section 4.4.

(6) During the Matching Period, the Purchasers shall have the right, but not the obligation, to propose to amend the terms of this Agreement. The Trustees will review any proposal by the Purchasers to amend the terms of this Agreement in good faith in order to determine (after consultation with their financial advisor and legal counsel) whether the transactions contemplated by this Agreement, taking into account the Purchasers' proposed amendments would, if consummated in accordance with its terms, result in the Superior Proposal ceasing to be a Superior Proposal. If the Trustees so determine, Sunrise REIT will enter into an amending agreement with the Purchasers reflecting such proposed amendment.

(7) Sunrise REIT shall, as promptly as practicable, notify the Purchasers of any relevant details relating to any Acquisition Proposal, or inquiry that could reasonably be expected to lead to any Acquisition Proposal, or any amendments to any Acquisition Proposal (including the identity of the parties and all material terms thereof), or any request for non-public information relating to Sunrise REIT or any of its Subsidiaries in connection with an Acquisition Proposal or inquiry that could reasonably be expected to lead to any Acquisition Proposal, or for access to the properties, books or records of Sunrise REIT or any of its Subsidiaries by any Person that informs Sunrise REIT or such Subsidiary that it is considering making, or has made, an Acquisition Proposal, or inquiry that could reasonably be expected to lead to any Acquisition Proposal, in each case which any of Sunrise REIT, any of its Subsidiaries or any officer, trustee, director, employee or Representative may receive after the date hereof relating to an Acquisition Proposal. Sunrise REIT shall promptly and fully keep the Purchasers informed of the status on a current basis, including any change to any of the terms, of any such Acquisition Proposal.

(8) Sunrise REIT shall

(i) ensure that its officers and Trustees and its Subsidiaries and their respective officers and directors and any Representatives retained by it or its Subsidiaries in connection herewith are aware of the provisions of this Section 4.4, and Sunrise REIT shall be responsible for any breach of this Section 4.4 by its and its Subsidiaries' officers, directors, trustees or representatives;

(ii) immediately cease and cause to be terminated any existing activities, discussions or negotiations with any parties conducted heretofore with respect to any Acquisition Proposal;

(iii) require all Persons other than the Purchasers who have been furnished with confidential information regarding Sunrise REIT or its Subsidiaries in connection with the solicitation of or discussion regarding any Acquisition Proposal within 12 months prior to the date hereof promptly to return or destroy such information, in accordance with and subject to the terms of the confidentiality agreement entered into with such Persons;

(iv) terminate access for all Persons (other than the Purchasers and its Representatives) of the electronic dataroom accessible through Merrill Datasite's website; and

(v) not amend, modify, waive or fail to enforce any of the standstill terms or other conditions included in any of the confidentiality agreements between Sunrise REIT and any third parties. (emphasis added)

14 The Purchase Agreement defines Acquisition Proposal and Superior Proposal as follows:

"Acquisition Proposal" means any proposal or offer made by any Person other than the Purchasers (or any affiliate of the Purchasers or any Person acting jointly and/or in concert with the Purchasers or any affiliate of the Purchasers) with respect to the acquisition, directly or indirectly, of assets, securities or ownership interests of or in Sunrise REIT or any of its Subsidiaries representing 20% or more of the consolidated assets of Sunrise REIT and its Subsidiaries taken as a whole, in a single transaction or a series of transactions, or of equity interests representing a 20% or greater economic interest in Sunrise REIT or such Subsidiaries taken as a whole, in a single transaction or a series of transactions pursuant to any merger, amalgamation, tender offer, share exchange, business combination, liquidation, dissolution, recapitalization, take-over or nonexempt issuer bid, amendment to the Declaration of Trust, redemption of units, extraordinary distribution, sale, lease, exchange, mortgage, pledge, transfer, purchase, or issuance as consideration or similar transaction or series of transactions involving Sunrise REIT or any of such Subsidiaries or any other transaction the consummation of which would reasonably expected to impede, interfere with, prevent or materially delay the transactions contemplated hereby.

"Superior Proposal" means any unsolicited bona fide written Acquisition Proposal made by a third party that in the good faith determination of the Trustees, after consultation with its financial advisors and with outside counsel:

(a) is reasonably capable of being completed without undue delay having regard to financial, legal, regulatory and other matters;

(b) in respect of which adequate arrangements have been made to ensure that the required funds will be available to effect payment in full of the consideration; and

(c) would, if consummated in accordance with its terms, result in a transaction more favourable to Unitholders from a financial point of view (including financing terms, any termination fee or expenses reimbursement payable under this Agreement, any conditions to the consummation thereof) than the transactions contemplated by this Agreement; provided, however, that for purposes of this definition the references in the definition of Acquisition Proposal to "20%" shall be deemed to be references to "100%".

15 In the event that a Superior Proposal emerges, the Purchase Agreement provides Ventas with both a "right to match" and in the event that it chooses not to match the proposal, subject to certain tax considerations, it receives a break fee of $39,800,000 if it terminates the Purchase Agreement.

16 On January 17, 2007, Sunrise REIT's solicitor wrote to HCP advising that Sunrise REIT had entered into an agreement with Ventas. Sunrise REIT's solicitor requested HCP to promptly return certain documents "pursuant to the terms of the Confidentiality Agreement between you and Sunrise REIT dated November 8, 2006 (the "Agreement")" and went on to write, "You are reminded that the terms of the Agreement, including those with respect to the continued confidentiality and use of the Evaluation Material (including any oral Evaluation Material), continue in force in accordance with its terms." HCP responded by returning confidential materials to Sunrise REIT's solicitor.

17 On February 14, 2007, HCP wrote to Sunrise REIT to submit a proposal on behalf of HCP to acquire Sunrise REIT. Sunrise REIT described the proposal as being "otherwise identical" to that contained in the Purchase Agreement with Ventas but for cash consideration of $18 per unit. This represented a 20% premium over the price offered by Ventas. HCP stated in its letter that its proposal was a Superior Proposal as defined in Ventas' Purchase Agreement and it trusted that Sunrise REIT's chairman and other trustees, in the proper exercise of their fiduciary duties to unitholders, would respond immediately and positively to its proposal. HCP also publicly announced its intention to make a bid to acquire Sunrise REIT.

18 Sunrise REIT concluded that it was not in a position to consider or make any determination as to whether HCP was a Superior Proposal as HCP's letter of February 14, 2007 suggested that the terms of the offer were conditional on HCP reaching an agreement with SSL. Sunrise REIT issued a press release to this effect on February 15, 2007.

19 On February 15, 2007, Ventas wrote to the president and CEO of Sunrise REIT advising that it had become aware that HCP had been in contact with two of Sunrise REIT's trustees, Messrs. Klassen and Newell, who are also the most senior executives of SSL. Ventas took the position that this contact could constitute a violation of HCP's confidentiality agreement of November, 2006 which Ventas asserted prohibited contact between HCP and SSL. Ventas stated that it understood that HCP's confidentiality agreement was the same as that of Ventas. Ventas also wrote to SSL.

20 On February 16, 2007, Sunrise REIT wrote to Ventas and stated that the term of the confidentiality agreements prohibiting contact as between HCP and Ventas on the one side and SSL on the other, had been waived and asked Ventas to confirm that it agreed that Sunrise REIT would not be in breach of the Purchase Agreement if discussions occurred as between HCP and SSL. This confirmation was not forthcoming from Ventas. On February 18 and 20, 2007, HCP wrote to Sunrise REIT with further proposals. HCP offered to enter an agreement with SSL that was identical in material respects to that entered into by Ventas and HCP stated that this therefore eliminated the need for SSL to engage in discussions with HCP. When Ventas discovered that HCP was still bound by the Standstill Agreement in its confidentiality agreement, Ventas wrote to Sunrise REIT requesting that it comply with the covenants in the Purchase Agreement and enforce its rights under the HCP confidentiality agreement. On February 19, 2007, Sunrise REIT commenced court proceedings as did Ventas on February 21, 2007 and SSL on February 21, 2007.

Relief Requested

21 Sunrise REIT applies for a declaration that the term in the confidentiality agreements between Sunrise REIT and Ventas, Sunrise REIT and HCP, and Sunrise REIT and SSL restricting SSL from having discussions or communications with either of HCP or Ventas with respect to Sunrise REIT has been waived by Sunrise REIT and that that waiver remains in effect. It also requests a declaration that Sunrise REIT is not and will not be in breach of the Ventas Purchase Agreement by reason of a discussion as between HCP and SSL as to its management of Sunrise REIT properties with a view towards ascertaining whether HCP and SSL can agree on management terms in the event that HCP succeeds in a bid for the assets of Sunrise REIT. It also requests a declaration that, in particular, section 4.4 of the Ventas Purchase Agreement does not apply to require Sunrise REIT to enforce terms of confidentiality agreements executed by Sunrise REIT which were waived prior to the execution of the Ventas Purchase Agreement.

22 Ventas applies for a declaration that Sunrise REIT, Sunrise REIT Trust and Sunrise REIT GP, Inc. are obligated pursuant to the Ventas Purchase Agreement to enforce the standstill terms and other conditions in the HCP confidentiality agreement. It also requests a declaration that the standstill terms set out in the HCP confidentiality agreement are in effect and remain in effect until May 8, 2008.

23 SSL applies for a declaration that the agreement set forth in a letter dated January 14, 2007 does not prohibit or in any way restrict SSL from engaging in discussions with HCP concerning SSL's management of Sunrise REIT properties with a view to ascertaining whether HCP and SSL can agree on management terms and changes to the various agreements currently in place between SSL and Sunrise REIT in the event that HCP succeeds in a bid for the assets of Sunrise REIT or other business combination with Sunrise REIT. SSL also requests a declaration that SSL is not and will not be in a breach of the confidentiality agreement between it and Sunrise REIT by reason of any discussions between SSL and HCP regarding SSL management of the Sunrise REIT properties and changes to the aforesaid various agreements in connection with HCP's bid to acquire Sunrise REIT.

24 Given the urgency of the matter, these applications proceeded in a very truncated time frame. I propose to address Ventas' application first.

Positions of the Parties

25 In brief, these are the parties' positions with respect to the Ventas application. Ventas submits that sophisticated commercial parties should be held to their contracts to ensure commercial certainty and to avoid commercial chaos. The auction process, which was designed to cause bidders to put their best foot forward, involved a set of "rules of

engagement". It is Ventas' position that as part of the auction process, a confidentiality agreement that included the Standstill Agreement was entered into by HCP and Sunrise REIT. Ventas played by the rules and won the auction. The benefits of winning the auction included a binding obligation on Sunrise REIT to enforce the HCP Standstill Agreement. It argues that the covenants in section 4.4 of the Ventas Purchase Agreement are clear. In the context of the auction process that led to the Purchase Agreement, the only objectively reasonable interpretation of Section 4.4(8)(v) is that any third parties bound by standstill terms with Sunrise REIT would continue to be bound by them and Sunrise REIT would enforce them. Any interpretation or argument that this obligation falls away in the face of an Acquisition Proposal made by a third party in breach of its standstill terms would deprive section 4.4(8)(v) of any meaning and would render it nugatory. In addition, Ventas argues that the HCP proposals do not satisfy the criteria that would permit 4.4(2) and 4.4(3) to oust the provisions of 4.4(1) in that they were not unsolicited or bona fide and they result from a breach of section 4.4. It is Ventas' position that Sunrise REIT and HCP should be held to their bargains. The rationale for deal protection devices such as the Standstill Agreement between Sunrise REIT and HCP is that, in a contested bidding situation, they encourage bidders to make their best bids. In any event, as set forth in the Purchase Agreement, Ventas states that ultimately it should be for the unitholders to decide which course to take.

26 Sunrise REIT does not take the position that the Purchase Agreement is ambiguous. Rather, it submits that Sunrise REIT contracted for a "fiduciary out" mechanism in the Purchase Agreement and these provisions were a fundamental aspect of the commercial context of the process that was designed to maximize value for the unitholders. It agreed with Ventas not to solicit further bids but was permitted to consider an unsolicited Acquisition Proposal made by any Person as those terms were defined in the Purchase Agreement. Ventas received significant benefits from being the winner "at the end of the first stage of the auction" as it had the right to match another proposal or walk away with a $39,800,000 break fee. If Ventas had wanted to exclude a person who had been involved in the auction, it could have used express language to do so. Counsel submits that sections 4.4(2) and 4.4(3) of the Purchase Agreement are engaged when Sunrise REIT receives an unsolicited Acquisition Proposal and these sections expressly supercede section 4.4(1). Furthermore, from a reading of 4.4(2) and 4.4(3), nothing, including section 4.4(8), should override Sunrise REIT's ability to consider unsolicited Acquisition Proposals and Superior Proposals. Sunrise REIT should be able to determine whether an Acquisition Proposal could be a Superior Proposal without being required to enforce a standstill provision. Counsel submits that Ventas' treatment of section 4.4(8) renders the obligation in 4.4(1) redundant and also ignores the word "nothing" in sections 4.4(2) and 4.4(3). Counsel argues that subsection 4.4(8) applies in circumstances other than those involving Acquisition Proposals. Furthermore, that section of the Purchase Agreement must be read in the context of the "fiduciary out" provisions in the manner advanced by Sunrise REIT. It is also more practical to proceed in the manner it describes given that the Ventas Purchase Agreement is subject to a vote of the unitholders before it can proceed. In its factum, Sunrise REIT acknowledged that the HCP Standstill Agreement continues to be outstanding and that it has not consented to the HCP proposal.

27 HCP makes substantially similar arguments to those of Sunrise REIT with respect to the interpretation to be given to the Purchase Agreement. HCP's counsel submits that the Purchase Agreement expressly permits HCP's Acquisition Proposal. The term Acquisition Proposal does not exclude proposals made by first round participants. Nothing could prevent Sunrise REIT from entering into a bona fide written unsolicited Acquisition Proposal as it had an obligation to its unitholders to design a process that would maximize unitholder value. The Ventas Purchase Agreement contemplates that any third party can make a subsequent unsolicited bid and if the bid is financially superior to the Ventas transaction, Sunrise REIT could accept the bid and terminate the Purchase Agreement with Ventas. This is clear from the wording of sections 4.4(2) and 4.4(3). The introductory words of those sections, "notwithstanding anything contained in section 4.4(1)" are not words of limitation but are for greater certainty. Unlike section 4.4(1), section 4.4(8) has no application to future discussions or negotiations with respect to a future unsolicited Acquisition Proposal. It does not apply to subsequent unsolicited bona fide Acquisition Proposals. In this regard, section 4.4(3) "occupies the field." HCP also submits that its proposal did not result from a breach of section 4.4; it was unsolicited, and bona fide. Subsequent conduct also supports the argument that section 4.4(3) applies to HCP's proposal.

28 In any event, HCP states that it received Sunrise REIT's prior written consent to make binding bids on December 29, 2006. The consent was not limited to any specified duration or in any other way. The consent was never revoked and the Standstill Agreement was never reinstated. HCP also submits that the benefits of the Standstill Agreement may not be assigned without its consent.

Discussion

(a) The Purchase Agreement

29 At its heart, this case involves issues of contractual interpretation. Therefore, I will start by addressing the appropriate principles of law that I should consider in interpreting the Purchase Agreement.

30 Firstly, as affirmed by the Court of Appeal in *Toronto Dominion Bank v. Leigh Instruments Ltd. (Trustee of)*,[2]

> The aim of the court, in construing a written agreement, is to determine the intentions of the parties to the agreement, and in this regard, the cardinal presumption is that the parties have intended what they have said. Their words must be construed as they stand.

Similar principles were expressed more recently in the Ontario Court of Appeal decision of *Venture Capital USA Inc. v. Yorkton Securities Inc.*[3]

> The cardinal rule of contract interpretation "is that the court should give effect to the intention of the parties as expressed in their written agreement", and where the intention of the parties "is plainly expressed in the language of the agreement, the court should not stray beyond the four corners of the agreement": *KPMG Inc. v. Canadian Imperial Bank of Commerce* [1998] O.J. No.4746 (C.A.), at para. 5, leave to appeal refused, [1999] S.C.C.A. No. 36, [1999] 2 S.C.R. vi; *Indian Molybdenum Ltd. v. R.*., [1951] 3 D.L.R. 497 (S.C.C.), at p. 502; *Eli Lilly & Co. v. Novopharm Ltd.*, [1998] 2 S.C.R. 129, [1998] S.C.J. No. 59, at pp. 166-68 S.C.R.

31 Secondly, I am to consider the Purchase Agreement as a whole.

> It is a cardinal rule of the construction of contracts that the various parts of the contract are to be interpreted in the context of the intentions of the parties as evident from the contract as a whole.:

BG Checo International Ltd. v. British Columbia Hydro & Power Authority[4] The court should also strive to give meaning to the agreement and "reject an interpretation that would render one of its terms ineffective": *Scanlon v. Castlepoint Development Corp.*[5]

32 As to surrounding circumstances, subjective intent and extrinsic evidence, Iacobucci J. stated in *Eli Lilly & Co. v. Novopharm Ltd.*,[6]

> The contractual intent of the parties is to be determined by reference to the words they used in drafting the document, possibly read in light of the surrounding circumstances which were prevalent at the time. Evidence of one party's subjective intention has no independent place in this determination.
>
> Indeed, it is unnecessary to consider any extrinsic evidence at all when the document is clear and unambiguous on its face. In the words of Lord Atkinson in *Lampson v. City of Quebec* (1920), 54 D.L.R. 344 (P.C.):
>
> > ... the intention by which the deed is to be construed is that of the parties as revealed by the language they have chosen to use in the deed itself ... [I]f the meaning of the deed, reading its words in their ordinary sense, be plain and unambiguous it is not permissible for the parties to it, while it stands unreformed, to come into a Court of justice and say: Our intention was wholly different from that which the language of our deed expresses...

> When there is no ambiguity in the wording of the document, the notion in *Consolidated Bathurst* that the interpretation which produces a "fair result" or "sensible commercial result" should be adopted is not determinative. Admittedly, it would be absurd to adopt an interpretation which is clearly inconsistent with the commercial interests of the parties, if the goal is to ascertain their true contractual intent. However, to interpret a plainly worded document in accordance with the true contractual intent of the parties is not difficult, if it is presumed that the parties intended the legal consequences of their words. [7]

33 The Court of Appeal addressed the issue of surrounding circumstances or the "factual matrix" in *Kentucky Fried Chicken Canada v. Scott's Food Services Inc.* [8] as follows:

> While the task of interpretation must begin with the words of the document and their ordinary meaning, the general context that gave birth to the document or its "factual matrix" will also provide the court with useful assistance. In the famous passage in *Reardon Smith Line Ltd. v. Yngvar Hansen-Tangen*, [1976] 1 W.L.R. 989 at 995-96 (H.L.) Lord Wilberforce said this:
>
> > No contracts are made in a vacuum: there is always a setting in which they have to be placed. The nature of what is legitimate to have regard to is usually described as "the surrounding circumstances" but this phrase is imprecise: it can be illustrated but hardly defined. In a commercial contract it is certainly right that the court should know the commercial purpose of the contract and this in turn presupposes knowledge of the genesis of the transaction, the background, the context, the market in which the parties are operating.
>
> The scope of the surrounding circumstances to be considered will vary from case to case but generally will encompass those factors which assist the court "... to search for an interpretation which, from the whole of the contract, would appear to promote or advance the true intent of the parties at the time of the entry into the contract." *Consolidated Bathurst Export Ltd. v. Mutual Boiler and Machinery Insurance Co.*, [1980] 1 S.C.R. 888 at 901.
>
> Where, as here, the document to be construed is a negotiated commercial document, the court should avoid an interpretation that would result in a commercial absurdity. [*City of Toronto v. W.H. Hotel Ltd.* (1966), 56 D.L.R. (2d) 539 at 548 (S.C.C.)]. Rather, the document should be construed in accordance with sound commercial principles and good business sense. [*Scanlon v. Castlepoint Development Corporation et al.* (1992), 11 O.R. (3d) 744 at 770 (Ont.C.A.)]. Care must be taken, however, to do this objectively rather than from the perspective of one contracting party or the other, since what might make good business sense to one party would not necessarily do so for the other.

34 With these broad principles of interpretation in mind, I turn to the construction to be given to section 4.4 of the Purchase Agreement. Properly construed, does it impose an obligation on Sunrise REIT to enforce the Standstill Agreement in the confidentiality agreement entered into by HCP and Sunrise REIT? In my view, it does for the following reasons.

35 Sunrise REIT expressly and unambiguously agreed that it would not amend, modify, waive or fail to enforce any of the standstill terms or other conditions included in any of the confidentiality agreements between Sunrise REIT and any third parties. The standstill enforcement obligations are found in sections 4.4(1) and 4.4(8) of the Purchase Agreement.

36 Sections 4.4(2) and 4.4(3) address Sunrise REIT's obligations with regard to "a bona fide written, unsolicited Acquisition Proposal (that did not result from a breach of this section 4.4)." Sections 4.4(2) and 4.4(3) are prefaced with the words "notwithstanding anything contained in section 4.4(1)." Sections 4.4(2) and (3) do not say "notwithstanding anything contained in section 4.4(1) or 4.4(8)." If it had been the parties' contractual intention to exempt the circumstances described in sections 4.4(2) and (3) from the operation of section 4.4(8), they could have so provided but they did not. Similarly, unlike sections 4.7 and 4.8 which commence with the words "notwithstanding any other term of the Agreement", sections 4.4(2) and 4.4(3) do not use this language.

37 It also should be observed that 4.4(2) and 4.4(3) contemplate a bona fide Acquisition Proposal. Bona fide means acting or done in good faith; sincere, genuine. [9] I agree with the submission of counsel for Ventas that a proposal made in breach of a contractual obligation not to make such a proposal cannot be considered to be bona fide. Sections 4.4(2) and 4.4(3) are not designed to address Acquisition Proposals that are not bona fide. So, for instance in this case, HCP is in breach of its Standstill Agreement and therefore HCP's proposals would not be encompassed by sections 4.4(2) and 4.4(3) because they could not be considered to be bona fide. Furthermore, sections 4.4(2) and 4.4(3) also contemplate an Acquisition Proposal from a third party that did not result from a breach of section 4.4. An Acquisition Proposal submitted in breach of a standstill agreement, to the extent it is considered by Sunrise REIT, would result from a breach of section 4.4. Again, in this case, sections 4.4(2) and 4.4(3) would be inapplicable on this ground as well.

38 It seems to me that the clear scheme of this Purchase Agreement was ensure enforcement of standstill agreements that had been signed as part of the auction process. This strikes me as being objectively reasonable and was a form of protection afforded to the purchaser, Ventas. This was part of the package negotiated between it and Sunrise REIT.

39 Such an interpretation derives from the words used by the parties to the Purchase Agreement and gives effect to the parties' intention. It is also consistent with the context of the transaction including the auction process which was the genesis of the Purchase Agreement. The Purchase Agreement does not preclude bona fide written unsolicited Acquisition Proposals nor does it preclude such a proposal from a party whose standstill agreement operated to permit such a proposal. [10] It simply precludes a proposal from anyone who is in breach of its standstill agreement. While creative, I view Sunrise REIT's and HCP's interpretation arguments to be strained. They disregard the parties' intention and the true meaning of the subject sections and the Purchase Agreement as a whole.

40 Lastly, in reaching this determination, it is unnecessary to have regard to any of the evidence of Ms. Cafaro of Ventas of which Sunrise REIT and HCP take exception.

41 In conclusion, I am of the view that the Purchase Agreement requires Sunrise REIT to enforce the HCP Standstill Agreement contained in the HCP confidentiality agreement.

(b) Prior Written Consent

42 The next issue to address is HCP's argument that, as required by the provisions of the Standstill Agreement, it received Sunrise REIT's prior written consent to submit its proposal. On December 29, 2006, Sunrise REIT invited Ventas and HCP to make binding bids in the second round of the auction process. HCP submits that these invitations constituted Sunrise REIT's prior written consent to both HCP and Ventas and that this consent was not limited to any specified duration or in any other way. [11]

43 In my view, this position is not borne out by the evidence. The December 29, 2006 letter from TD Securities invites HCP "to submit *a* detailed *final* binding proposal (a "Proposal") for the acquisition of the REIT" (emphasis added) and goes on to state "You should not assume that you will be given an opportunity to rebid, renegotiate, or improve the terms of your Proposal." This letter cannot possibly be construed as constituting Sunrise REIT's prior written consent as that term is used in the Standstill Agreement. Furthermore, on January 17, 2007, Sunrise REIT's solicitor reminded HCP that the terms of the confidentiality agreement continued in force. The confidentiality agreement of course contained the Standstill Agreement. In addition, the proposal most recently provided by HCP to Sunrise REIT provides that "Sunrise REIT hereby waives the standstill provisions." If consent had already been provided, this language would be unnecessary. Lastly, Sunrise REIT also takes the position that the Standstill Agreement continues to bind HCP and that it has not provided consent. In my view, the facts are inconsistent with a conclusion that Sunrise REIT provided its consent pursuant to the provisions of the Standstill Agreement so as to obviate the need for HCP to comply with the Standstill Agreement and for Sunrise REIT to be relieved of its obligation to enforce it.

(c) Assignment

44 There is also no merit in HCP's argument that the benefit of the HCP Standstill Agreement was assigned to Ventas without HCP's consent. Neither the Standstill Agreement nor its benefit has been assigned. Ventas only requests that Sunrise REIT comply with its obligation to enforce the Standstill Agreement.

(d) Remaining Applications

45 I am of the view that having found in favour of Ventas with respect to its application, the subject matter of the other two applications is moot. The question whether HCP can have discussions with SSL about Sunrise REIT is of no practical significance as they would be discussions absent a proposal that could not be made or considered. Furthermore, on February 20, 2007, HCP wrote to Sunrise REIT stating that the need to engage in discussions with SSL was eliminated.

> ... our offer to enter into an agreement with [SSL] identical in material respects to that entered into by Ventas eliminates the need for [SSL] to engage in any discussion or communications with HCP and therefore can be accepted irrespective of any such concerns.

A court should not grant declaratory relief where the issue has become academic and therefore declaratory relief would serve no useful purpose: *Solosky v. Canada* [12] and *Lee v. Canada (Minister of Citizenship & Immigration)*. [13]

Conclusion

46 In conclusion, I note that the parties to this transaction were experienced and sophisticated. They had financial advisors and legal representation from prominent law firms. Absent an established legal principle such as rectification, it is not the role of the courts to rewrite contracts entered into by sophisticated commercial parties. The relief set forth in paragraph (a) of the notice of application of Ventas is granted as is the request for a declaration that the standstill terms in the HCP confidentiality agreement are in effect. I am not granting Ventas' request for a declaration that the standstill terms remain in effect until May 8, 2008 as, as noted by Ventas in its factum, if the unitholders reject Ventas' offer, the Purchase Agreement may be terminated by Sunrise REIT thereby relieving Sunrise REIT of its obligations under the Agreement, including the standstill enforcement obligation at issue in this case. The applications of Sunrise REIT and SSL are dismissed. If the parties are unable to agree on costs, they are to make brief written submissions.

Application granted.

Footnotes

* Judgment affirmed at *Ventas Inc. v. Sunrise Senior Living Real Estate Investment Trust* (2007), 56 R.P.R. (4th) 163, 2007 CarswellOnt 1705, 222 O.A.C. 102, 2007 ONCA 205, 29 B.L.R. (4th) 312 (Ont. C.A.).

1 Eg. HCP or Ventas.

2 (1998), 40 B.L.R. (2d) 1 (Ont. Gen. Div. [Commercial List]) at para. 403, affirmed (1999), 45 O.R. (3d) 417 (Ont. C.A.).

3 (2005), 75 O.R. (3d) 325 (Ont. C.A.), at 333.

4 [1993] 1 S.C.R. 12 (S.C.C.) at p. 23.

5 (1992), 11 O.R. (3d) 744 (Ont. C.A.), at 770.

6 [1998] 2 S.C.R. 129 (S.C.C.).

7 P. 166.

8 (Ont. C.A.) at para.25-27.

9 Oxford English Dictionary, Oxford University Press, 2007.

10 As for example, Ventas.

11 See para. 20 of the HCP factum.

12 (1979), [1980] 1 S.C.R. 821 (S.C.C.), at 832.

13 (1997), 126 F.T.R. 229 (Fed. T.D.), at 233.

End of Document

TAB B

2007 ONCA 205
Ontario Court of Appeal

Ventas Inc. v. Sunrise Senior Living Real Estate Investment Trust

2007 CarswellOnt 1705, 2007 ONCA 205, [2007] O.J. No. 1083, 156 A.C.W.S. (3d) 95, 222 O.A.C. 102, 29 B.L.R. (4th) 312, 56 R.P.R. (4th) 163, 85 O.R. (3d) 254

VENTAS, INC., 2124678 ONTARIO INC., and 2124680 ONTARIO INC. (Applicants / Respondents in Appeal) and SUNRISE SENIOR LIVING REAL ESTATE INVESTMENT TRUST, SUNRISE REIT TRUST, SUNRISE REIT GP, INC., SUNRISE SENIOR LIVING INC., and HEALTH CARE PROPERTY INVESTORS, INC. (Respondents / Appellants in Appeal)

SUNRISE SENIOR LIVING REAL ESTATE INVESTMENT TRUST, SUNRISE REIT TRUST, and SUNRISE REIT GP, INC. (Applicants / Appellants in Appeal) and VENTAS SSL ONTARIO II, INC. (FORMERLY 2124678 ONTARIO INC.), VENTAS SSL ONTARIO I, INC. (FORMERLY 2124680 ONTARIO INC.), VENTAS INC., SUNRISE SENIOR LIVING, INC., and HEALTH CARE PROPERTY INVESTORS, INC. (Respondents / Respondents in Appeal / Ventas Inc. and numbered companies) (Appellant by Cross-Appeal / Health Care Property Investors, Inc.)

R.A. Blair, J. MacFarland, H.S. LaForme JJ.A.

Heard: March 20, 2007
Judgment: March 23, 2007
Docket: CA C46790, C46791

Proceedings: affirming *Ventas Inc. v. Sunrise Senior Living Real Estate Investment Trust* (2007), 2007 CarswellOnt 1704, 29 B.L.R. (4th) 292 (Ont. S.C.J.)

Counsel: Peter F.C. Howard, Eliot Kolers for Appelants, Sunrise Senior Living Real Estate Investment Trust, Sunrise REIT Trust, Sunrise REIT GP Inc.
Jeffrey S. Leon, Derek J. Bell for Appellants, Health Care Property Investors Inc.
Mark A. Gelowitz, Laura K. Fric for Respondents, Ventas Inc., Numbered Companies
Luis G. Sarabia, Cynthia Spry for Respondent, Sunrise Senior Living Inc.

Subject: Corporate and Commercial; Contracts; Property; Public

Headnote

Business associations --- Powers, rights and liabilities — Contracts by corporations — Miscellaneous issues

Real estate investment trust was publicly traded entity — Board of trustees decided to sell assets and developed two-stage auction process to maximize value of units — Parties interested in purchasing were required to enter into confidentiality agreements with trust — Confidentiality agreements contained standstill terms prohibiting contact between either potential purchaser and trust's subsidiary — Corporation entered into agreement with trust to purchase assets — Third party learned of agreement and sent last-ditch proposal to trust — Trust told third party to enter discussions with representatives from its subsidiary — Corporation refused to waive standstill terms of agreement — Corporation's application for declaration that trust was obliged to enforce standstill terms in confidentiality agreement was granted — Trust appealed — Third party cross-appealed for declaration that communications between it and subsidiary of trust were permitted — Appeal dismissed; cross-appeal dismissed — Trust was obliged to enforce standstill terms — Judge correctly outlined and applied principles of contract

interpretation — Judge was correct that important purpose of s. 4.4 of purchase agreement was to ensure enforcement of standstill agreements entered into by previous players in auction process — Fiduciary out clause did not apply where unsolicited proposal was tendered in breach of non-solicitation provisions of purchase agreement — Fiduciary out clause did not allow trust to resile from terms of its standstill agreements with earlier bidders — Judge was sensitive to fiduciary out provisions that permitted other bona fide written unsolicited acquisition proposals — Judge found this was balanced by requirement that trust ensure enforcement of standstill agreements signed as part of auction process in order to protect successful bidder — This interpretation made commercial sense — Judge did not err in her assessment and use of term "bona fide" — Issue on cross-appeal was moot since ruling precluded third party proposal from being pursued.

Table of Authorities

Cases considered by *R.A. Blair J.A.*:

ACE Ltd. v. Capital Re Corp. (1999), 747 A.2d 95 (U.S. Del. Ch.) — referred to

BG Checo International Ltd. v. British Columbia Hydro & Power Authority (1993), 1993 CarswellBC 1254, [1993] 2 W.W.R. 321, [1993] 1 S.C.R. 12, 147 N.R. 81, 75 B.C.L.R. (2d) 145, 99 D.L.R. (4th) 577, 20 B.C.A.C. 241, 35 W.A.C. 241, 14 C.C.L.T. (2d) 233, 5 C.L.R. (2d) 173, 1993 CarswellBC 10 (S.C.C.) — referred to

Consolidated-Bathurst Export Ltd. c. Mutual Boiler & Machinery Insurance Co. (1979), (sub nom. *Exportations Consolidated-Bathurst Ltée c. Mutual Boiler & Machinery Insurance Co.*) [1980] 1 S.C.R. 888, 112 D.L.R. (3d) 49, 1979 CarswellQue 157, 1979 CarswellQue 157F, 32 N.R. 488, [1980] I.L.R. 1-1176 (S.C.C.) — referred to

CW Shareholdings Inc. v. WIC Western International Communications Ltd. (1998), 39 O.R. (3d) 755, 160 D.L.R. (4th) 131, 1998 CarswellOnt 1891, 38 B.L.R. (2d) 196 (Ont. Gen. Div. [Commercial List]) — referred to

Eli Lilly & Co. v. Novopharm Ltd. (1998), 227 N.R. 201, 152 F.T.R. 160 (note), 1998 CarswellNat 1061, 1998 CarswellNat 1062, 161 D.L.R. (4th) 1, [1998] 2 S.C.R. 129, 80 C.P.R. (3d) 321 (S.C.C.) — referred to

Kentucky Fried Chicken Canada v. Scott's Food Services Inc. (1998), 1998 CarswellOnt 4170, 41 B.L.R. (2d) 42, 114 O.A.C. 357 (Ont. C.A.) — considered

Paramount Communcations Inc. v. QVC Network Inc. (1994), 637 A.2d 34, 62 U.S.L.W. 2530, Fed. Sec. L. Rep. P 98,063 (U.S. Del. Super.) — referred to

Pente Investment Management Ltd. v. Schneider Corp. (1998), 113 O.A.C. 253, (sub nom. *Maple Leaf Foods Inc. v. Schneider Corp.*) 42 O.R. (3d) 177, 1998 CarswellOnt 4035, 44 B.L.R. (2d) 115 (Ont. C.A.) — considered

Scanlon v. Castlepoint Development Corp. (1992), 29 R.P.R. (2d) 60, 59 O.A.C. 191, 11 O.R. (3d) 744, 99 D.L.R. (4th) 153, 1992 CarswellOnt 633 (Ont. C.A.) — referred to

Toronto Dominion Bank v. Leigh Instruments Ltd. (Trustee of) (1998), 1998 CarswellOnt 2565, 40 B.L.R. (2d) 1 (Ont. Gen. Div. [Commercial List]) — referred to

Toronto Dominion Bank v. Leigh Instruments Ltd. (Trustee of) (1999), 45 O.R. (3d) 417, (sub nom. *Toronto-Dominion Bank v. Leigh Instruments Ltd. (Bankrupt)*) 124 O.A.C. 87, 178 D.L.R. (4th) 634, 50 B.L.R. (2d) 64, 1999 CarswellOnt 2812 (Ont. C.A.) — referred to

Venture Capital USA Inc. v. Yorkton Securities Inc. (2005), 2005 CarswellOnt 1875, 197 O.A.C. 264, 75 O.R. (3d) 325, 4 B.L.R. (4th) 324 (Ont. C.A.) — referred to

APPEAL by public real estate trust from decision reported at *Ventas Inc. v. Sunrise Senior Living Real Estate Investment Trust* (2007), 56 R.P.R. (4th) 184, 2007 CarswellOnt 1704, 29 B.L.R. (4th) 292 (Ont. S.C.J.), granting application by corporation for declaration that trust was obligated to enforce confidentiality agreement; CROSS-APPEAL by third party for declaration that communications between it and subsidiary of trust were permitted.

***R.A. Blair J.A.*:**

Overview

1 Sunrise REIT is a Canadian public real estate investment trust whose units are traded on the Toronto Stock Exchange. It owns and invests in senior living communities in Canada and the United States. In September 2006, Sunrise's board of trustees determined that a strategic sale process of its assets would be beneficial to its unitholders, thus effectively putting Sunrise "in play" on the public markets.

2 To carry out this plan, the Trustees developed a two-stage auction process with a view to maximizing the value of Sunrise's units. Ventas, Inc. ("Ventas") and Health Care Property Investors, Inc. ("HCPI") were two of seven initially interested prospective purchasers in the auction process. They emerged from the preliminary round as the only two potential bidders asked to participate in the final round.

3 Ventas submitted a successful bid to acquire all of Sunrise's assets for a total purchase price of $1,137,712,410 (representing a price of $15 per unit), subject to unitholder approval. HCPI withdrew from the auction process and did not bid at that time. Instead, it put forward a post-auction bid — after it knew what Ventas had offered — "topping up" the Ventas offer by twenty per cent to $18 per unit. This increased offer represents an additional $227.5 million for the unitholders, who are to meet on March 30, 2007, to consider the Ventas proposal.

4 Hence the urgency of this appeal.

5 The appeal turns on the interpretation of the terms of the purchase agreement executed by Sunrise and Ventas following acceptance of the Ventas bid. The issue is whether Sunrise is obliged to enforce the terms of a prior standstill agreement entered into between it and HCPI in the course of the auction process and which prohibits HCPI from making an offer for the Sunrise assets without Sunrise's consent. If the answer to that question is "Yes", Sunrise will be precluded from considering or accepting the richer HCPI offer pending the unitholders' meeting.

6 Following an urgent application, determined on March 6, 2007, Justice Pepall answered the foregoing question in the affirmative. Sunrise and HCPI appeal from that decision. Ventas supports it.

7 For the reasons that follow, I would dismiss the appeal and uphold the decision of the application judge.

Facts

8 As mentioned above, Sunrise owns and invests in senior living communities in Canada and the United States. The properties are managed by Sunrise Senior Living, Inc. ("SSL"), a U.S. public company whose shares are traded on the New York Stock Exchange.

9 HCPI is a self-administered real estate investment trust that also invests in healthcare facilities. Ventas is a U.S.-based health care real estate investment trust whose shares are listed on the New York Stock Exchange.

10 In September 2006, after Sunrise's board of trustees determined that a strategic sale process of the Trust's assets would be beneficial to its unitholders, it began an auction process with a view to maximizing unitholder value.

11 Parties who were interested in acquiring Sunrise (including HCPI and Ventas) were required to enter into a confidentiality agreement with it in order to prevent non-public information exchanged by the parties from being publicly disclosed (the "Confidentiality Agreements"). The Confidentiality Agreements contained restrictions preventing each prospective acquiring party from attempting a hostile (unsolicited) takeover bid (the "Standstill Agreements").

12 Although the parties' Confidentiality Agreements were largely similar, Ventas's Standstill Agreement was worded differently from HCPI's in that the Ventas standstill ceased to apply if, among other things, Sunrise entered into an agreement to sell more than twenty per cent of its assets to a third party. Notably, HCPI's Standstill Agreement did not contain a similar termination clause.

13 On November 21, 2006, Sunrise invited potential bidders to submit bids in the non-binding preliminary round of an auction. After the first round of bids, Sunrise invited HCPI and Ventas to engage in further negotiations and on December 29, 2006, it invited them to submit final binding bids in the second round of the auction by January 8, 2007. Sunrise waived the Standstill Agreements with those bidders for that purpose, and HCPI and Ventas were expressly told not to assume that the "winning" bid was assured of actually acquiring Sunrise at the price agreed upon or that they would be given an opportunity to rebid, renegotiate, or improve the terms of their proposal.

14 Ventas submitted a second bid on January 8, but HCPI withdrew from the auction and did not.

15 On January 14, 2007, Ventas and Sunrise signed an agreement contemplating the purchase by Ventas of all of Sunrise's assets for a total purchase price of $1,137,712,410 (representing a price of $15.00 per Unit), subject to Unitholder approval (the "Purchase Agreement"). This price represented a 35.8% premium over the closing price of the units on January 12, 2007. The Purchase Agreement contemplated subsequent third-party unsolicited bids and allowed Sunrise to accept such a bid if it was financially superior to Ventas's bid.

16 On January 17, 2007, Sunrise notified HCPI of the agreement with Ventas and asked for the return of Sunrise's confidential materials. In the letter, Sunrise's solicitor reminded HCPI of the terms of the Confidentiality Agreement it signed in November 2006.

17 On February 14, 2007, HCPI submitted a proposal to acquire all of Sunrise's assets for $18.00 per unit (the "HCPI Proposal"), conditional on HCPI's ability to reach a management agreement with SSL. Sunrise treated the HCPI Proposal as an unsolicited third-party bid, but it concluded that it was not in a position to determine whether the bid was a superior bid because of the SSL condition.

18 The Confidentiality Agreements entered into in the course of the auction process contained a provision prohibiting prospective purchasers from communicating with SSL. This was because SSL was viewed as a possible bidder. Following the preliminary round of the auction, in late November 2006, and after realizing that SSL was not an interested purchaser, Sunrise had authorized its financial advisors to arrange to allow HCPI and Ventas to contact SSL for purposes of the second round of bidding. On February 15, 2007, however — after learning of the HCPI Proposal — Ventas advised Sunrise that, if it permitted communications between SSL and HCPI, Sunrise would be in breach of the Purchase Agreement. It did not assert that HCPI would be in breach of its Standstill Agreement because it apparently assumed that HCPI's Standstill Agreement was worded similarly to the Ventas Standstill Agreement, which meant that the restraint on an unsolicited bid was no longer enforceable since Sunrise had entered into an agreement with a third party.

19 On February 18, 2007, Sunrise served application materials upon Ventas, HCPI and SSL indicating its intention to seek the court's interpretation of the Purchase Agreement, specifically on the issue of communications between HCPI and SSL. It is at this point that Ventas learned of the specific terms of HCPI's Confidentiality Agreement and realized that HCPI's Standstill Agreement did not contain the same termination clause as Ventas's Standstill Agreement. On February 21, 2007, Ventas brought the within Application seeking a declaration that Sunrise was required to enforce its Standstill Agreement with HCPI, thereby preventing it from considering the HCPI Proposal.

20 The application judge found that Sunrise had agreed with Ventas that it would enforce existing Standstill Agreements and that any bid made in breach of an existing Standstill Agreement would not be *bona fide*. She then concluded that Sunrise was required to enforce the Standstill Agreement with HCPI and that HCPI did not have prior written consent to submit its bid. She dismissed Sunrise's application on the grounds that the issue was moot in light of her earlier conclusion.

The Provisions of the Agreement

21 Section 4 of the Purchase Agreement deals generally with the covenants of the parties. Section 4.4 deals with Sunrise's "Covenants Regarding Non-Solicitation". Because of their importance, I reproduce the provisions of section 4.4 in their entirety (the underlining is mine):

> 4.4(1) Following the date hereof, Sunrise REIT shall not, directly or indirectly, through any trustee, officer, director, agent or Representative of Sunrise REIT or any of its Subsidiaries, and shall not permit any such Person to,
>
> (i) solicit, initiate, encourage or otherwise facilitate (including by way of furnishing information or entering into any form of agreement, arrangement or understanding or providing any other form of assistance) the initiation of any inquiries or proposals regarding, or other action that constitutes, or may reasonably be expected to lead to, an actual or potential Acquisition Proposal,
>
> (ii) participate in any discussions or negotiations in furtherance of such inquiries or proposals or regarding an actual potential Acquisition Proposal or release any Person from, or fail to enforce, any confidentiality or standstill agreement or similar obligations to Sunrise REIT or any of its Subsidiaries,
>
> (iii) approve, recommend or remain neutral with respect to, or propose publicly to approve, recommend or remain neutral with respect to, any Acquisition Proposal,
>
> (iv) accept or enter into any agreement, arrangement or understanding, related to any Acquisition Proposal (other than a confidentiality agreement contemplated in Section 4.4(2)), or
>
> (v) withdraw, modify or qualify, or publicly propose to withdraw, modify or qualify, in any manner adverse to the Purchasers, the approval or recommendation of the Board (including any committee thereof) of this Agreement or the transactions contemplated hereby.
>
> (2) Notwithstanding anything contained in Section 4.4(1), until the Unitholder Approval, nothing shall prevent the Board from complying with Sunrise REIT's disclosure obligations under applicable Laws with regard to a bona fide written, unsolicited Acquisition Proposal or, following the receipt of any such Acquisition Proposal from a third party (that did not result from a breach of this Section 4.4), from furnishing or disclosing non-public information to such Person if and only to the extent that:
>
> (i) the Board believes in good faith (after consultation with its financial advisor and legal counsel) that such Acquisition Proposal if consummated could reasonably be expected to result in a Superior Proposal; and
>
> (ii) such third party has entered into a confidentiality agreement containing terms in the aggregate no more favourable to such third party than those in the Confidentiality Agreement as are then in effect in accordance with its terms.
>
> (3) Notwithstanding anything, contained in Section 4.4(1), until the Unitholder Approval, nothing shall prevent the Board from withdrawing or modifying, or proposing publicly to withdraw or modify its approval and recommendation of the transactions contemplated by this Agreement, or accepting, approving or recommending or entering into any agreement, understanding or arrangement providing for a bona fide written, unsolicited

Acquisition Proposal (that did not result from a breach of this Section 4.4) ("Proposed Agreement") if and only to the extent that:

(i) it has provided the Purchasers with a copy of all of the documents relating to the Acquisition Proposal,

(ii) the Board, believes in good faith (after consultation with its financial advisor and legal counsel) that such Acquisition Proposal constitutes a Superior Proposal and has promptly notified the Purchasers of such determination,

(iii) a period of at least five Business Days (the "Matching Period") has elapsed following the later of (x) the date the Purchasers received written notice advising the Purchasers that the Board has resolved, subject to compliance with this Section 4.4(3), to withdraw, modify its approval and recommendation of the transactions contemplated by this Agreement or accept, approve or recommend or enter into a Proposed Agreement in respect of such Superior Proposal and (y) the date the Purchasers received a copy of the documentation related to such Superior Proposal pursuant to Section 4.4(3)(i),

(iv) if the Purchasers have proposed to amend the transactions contemplated under this Agreement in accordance with Section 4.4(6), the Board has again made the determination in Section 4.4(3)(ii) taking into account such proposed amendments; and

(v) if Sunrise REIT proposes to enter into a Proposed Agreement (other than a confidentiality agreement referred to in Section 4.4(2)) after complying with this Section 4.4(3), Sunrise REIT shall have complied with Section 5.2 and 5.3. For the purposes of this Section 4.4(3) the preparation and delivery of a directors' circular pursuant to Section 99 of the *Securities Act* relating to an Acquisition Proposal shall be deemed to be a qualification, withdrawal or modification, of the Board's recommendation of the transactions contemplated hereby unless the Board expressly, and without qualification, reaffirms its recommendation of the transactions contemplated hereby in such disclosure.

(4) If the expiry of the Matching Period referred to in Section 4.4(3)(iii) falls on a date which is less than five Business Days prior to the Unitholder Meeting, Sunrise REIT shall, at the request of the Purchasers, adjourn the Unitholder Meeting to a date that is not more than 10 Business Days following such expiry date.

(5) Sunrise REIT acknowledges and agrees that each successive amendment to any Acquisition Proposal shall constitute a new Acquisition Proposal for purposes of section 4.4.

(6) During the Matching Period, the Purchasers shall have the right, but not the obligation, to propose to amend the terms of this Agreement. The Trustees will review any proposal by the Purchasers to amend the terms of this Agreement in good faith in order to determine (after consultation with their financial advisor and legal counsel) whether the transactions contemplated by this Agreement, taking into account the Purchasers' proposed amendments would, if consummated in accordance with its terms, result in the Superior Proposal ceasing to be a Superior Proposal. If the Trustees so determine, Sunrise REIT will enter into an amending agreement with the Purchasers reflecting such proposed amendment.

(7) Sunrise REIT shall, as promptly as practicable, notify the Purchasers of any relevant details relating to any Acquisition Proposal, or inquiry that could reasonably be expected to lead to any Acquisition Proposal, or any amendments to any Acquisition Proposal (including the identity of the parties and all material terms thereof), or any request for non-public information relating to Sunrise REIT or any of its Subsidiaries in connection with an Acquisition Proposal or inquiry that could reasonably be expected to lead to any Acquisition Proposal, or for access to the properties, books or records of Sunrise REIT or any of its Subsidiaries by any Person that informs Sunrise REIT or such Subsidiary that it is considering making, or has made, an Acquisition Proposal, or inquiry that could reasonably be expected to lead to any Acquisition Proposal, in each case which any of Sunrise REIT, any of its Subsidiaries or any officer, trustee, director, employee or Representative may receive after the date hereof relating

to an Acquisition Proposal. Sunrise REIT shall promptly and fully keep the Purchasers informed of the status on a current basis, including any change to any of the terms, of any such Acquisition Proposal.

(8) Sunrise REIT shall

(i) ensure that its officers and Trustees and its Subsidiaries and their respective officers and directors and any Representatives retained by it or its Subsidiaries in connection herewith are aware of the provisions of this Section 4.4, and Sunrise REIT shall be responsible for any breach of this Section 4.4 by its and its Subsidiaries' officers, directors, trustees or representatives;

(ii) immediately cease and cause to be terminated any existing activities, discussions or negotiations with any parties conducted heretofore with respect to any Acquisition Proposal;

(iii) require all Persons other than the Purchasers who have been furnished with confidential information regarding Sunrise REIT or its Subsidiaries in connection with the solicitation of or discussion regarding any Acquisition Proposal within 12 months prior to the date hereof promptly to return or destroy such information, in accordance with and subject to the terms of the confidentiality agreement entered into with such Persons;

(iv) terminate access for all Persons (other than the Purchasers and its Representatives) of the electronic dataroom accessible through Merrill Datasite's website; and

(v) not amend, modify, waive or fail to enforce any of the standstill terms or other conditions included in any of the confidentiality agreements between Sunrise REIT and any third parties.

22 The Purchase Agreement defines "Acquisition Proposal" and "Superior Proposal" as follows:

"Acquisition Proposal" means any proposal or offer made by any Person other than the Purchasers (or any affiliate of the Purchasers or any Person acting jointly and/or in concert with the Purchasers or any affiliate of the Purchasers) with respect to the acquisition, directly or indirectly, of assets, securities or ownership interests of or in Sunrise REIT or any of its Subsidiaries representing 20% or more of the consolidated assets of Sunrise REIT and its Subsidiaries taken as a whole, in a single transaction or a series of transactions, or, of equity interests representing a 20% or greater economic interest in Sunrise REIT or such Subsidiaries taken as a whole, in a single transaction or a series of transactions pursuant to any merger, amalgamation, tender offer, share exchange, business combination, liquidation, dissolution, recapitalization, take-over or non-exempt issuer bid, amendment to the Declaration of Trust, redemption of units, extraordinary distribution, sale, lease, exchange, mortgage, pledge, transfer, purchase, or issuance as consideration or similar transaction or series of transactions involving Sunrise REIT or any of such Subsidiaries or any other transaction the consummation of which would reasonably expected to impede, interfere with, prevent or materially delay the transactions contemplated hereby.

"Superior Proposal" means any unsolicited bona fide written Acquisition Proposal made by a third party that in the good faith determination of the Trustees, after consultation with its financial advisors and with outside counsel:

(a) is reasonably capable of being completed without undue delay having regard to financial, legal, regulatory and other matters;

(b) in respect of which adequate arrangements have been made to ensure that the required funds will be available to effect payment in full of the consideration; and

(c) would, if consummated in accordance with its terms, result in a transaction more favourable to Unitholders from a financial point of view (including financing terms, any termination fee or expenses reimbursement payable under this Agreement, any conditions to the consummation thereof) than the transactions contemplated by this Agreement; provided, however, that for purposes of this definition the references in the definition of Acquisition Proposal to "20%" shall be deemed to be references to "100%".

Analysis

23 The central issue on this appeal, as it was before the application judge, is whether the provisions of section 4.4 of the Purchase Agreement impose an obligation on Sunrise to enforce the Standstill Agreement between it and HCPI, thus precluding it from considering the Acquisition Proposal submitted by HCPI following the close of the auction and after the Ventas bid had been accepted. In my view, they do.

24 Counsel accept that the application judge correctly outlined the principles of contractual interpretation applicable in the circumstances of this case. I agree. Broadly stated — without reproducing in full the relevant passages from her reasons (paras. 29-34) in full — she held that a commercial contract is to be interpreted,

> (a) as a whole, in a manner that gives meaning to all of its terms and avoids an interpretation that would render one or more of its terms ineffective; [1]
>
> (b) by determining the intention of the parties in accordance with the language they have used in the written document and based upon the "cardinal presumption" that they have intended what they have said; [2]
>
> (c) with regard to objective evidence of the factual matrix underlying the negotiation of the contract, but without reference to the subjective intention of the parties; [3] and (to the extent there is any ambiguity in the contract),
>
> (d) in a fashion that accords with sound commercial principles and good business sense, and that avoid a commercial absurdity. [4]

25 The appellants assert, however, that the application judge misapplied the principles of contractual interpretation that she had properly enunciated. They say she did so essentially,

> a) by misapprehending the interplay between sections 4.4(1), 4.4(2), 4.4(3) and 4.4(8)(v) of the Purchase Agreement and, in particular by failing to appreciate, and to reconcile, the differences between the wording of sections 4.4(1) and 4.4(8), and more generally,
>
> b) by failing to understand the "architecture" of section 4.4 of the Purchase Agreement and to consider it against the background of the factual matrix in which the Agreement was negotiated.

26 I do not agree.

The Application Judge's Reasoning

27 The thrust of the application judge's reasoning in this regard is found at paragraphs 35, 36, 38 and 39 of her reasons:

> 35 Sunrise REIT expressly and unambiguously agreed that it would not amend, modify, waive or fail to enforce any of the standstill terms or other conditions included in any of the confidentiality agreements between Sunrise REIT and any third parties. The standstill enforcement obligations are found in sections 4.4(1) and 4.4(8) of the Purchase Agreement.
>
> 36 Sections 4.4(2) and 4.4(3) address Sunrise REIT's obligations with regard to "a bona fide written, unsolicited Acquisition Proposal (that did not result from a breach of this section 4.4)." Sections 4.4(2) and 4.4(3) are prefaced with the words "notwithstanding anything contained in section 4.4(1)." Sections 4.4(2) and (3) do not say "notwithstanding anything contained in section 4.4(1) or 4.4(8)." If it had been the parties' contractual intention to exempt the circumstances described in sections 4.4(2) and (3) from the operation of section 4.4(8), they could have so provided but they did not. Similarly, unlike sections 4.7 and 4.8 which commence with the words "notwithstanding any other term of the Agreement", sections 4.4(2) and 4.4(3) do not use this language.

> 38 It seems to me that the clear scheme of this Purchase Agreement was [to] ensure enforcement of standstill agreements that had been signed as part of the auction process. This strikes me as being objectively reasonable and was a form of protection afforded to the purchaser, Ventas. This was part of the package negotiated between it and Sunrise REIT.
>
> 39 Such an interpretation derives from the words used by the parties to the Purchase Agreement and gives effect to the parties' intention. It is also consistent with the context of the transaction including the auction process which was the genesis of the Purchase Agreement. The Purchase Agreement does not preclude bona fide written unsolicited Acquisition Proposals nor does it preclude such a proposal from a party whose standstill agreement operated to permit such a proposal. It simply precludes a proposal from anyone who is in breach of its standstill agreement. While creative, I view Sunrise REIT's and HCP's interpretation arguments to be strained. They disregard the parties' intention and the true meaning of the subject sections and the Purchase Agreement as a whole.
>
> [Footnote omitted.]

The Scheme and Interpretation of Section 4.4

28 I agree with the application judge that an important purpose of this part of the Purchase Agreement is to ensure the enforcement of standstill agreements entered into by previous players in the auction process. The negotiating context demonstrates that Ventas has been skilful in protecting its own position with respect to competition and standstills — unlike the HCPI Standstill, the Ventas/Sunrise Standstill Agreement expired at the conclusion of the auction — and it is objectively reasonable, given this background, that it would seek protection against competition from those who were unsuccessful in the auction, particularly its principle competitor.

29 From Sunrise's perspective, the safety valve lies in the unitholders' meeting. If the unitholders believe that there is a more favourable offer available — one worth the risk of rejecting the Ventas proposal — they may well vote to reject the Ventas proposal at their meeting on March 30.

30 The language used by the parties in the Purchase Agreement supports this interpretation.

31 Viewed contextually, sections 4.4(1), 4.4(2), 4.4(3) and 4.4(8) form part of a section of the Purchase Agreement that deals with the general covenant of Sunrise not to shop for other offers pending unitholder consideration of the Ventas bid. Viewed in light of the factual matrix in which the Agreement was negotiated, the provisions provide deal protection for Ventas, as the successful bidder in the auction, subject to Sunrise REIT's fiduciary out obligations.

32 As I read section 4.4 of the Agreement, it has four major components. First, it contains the overriding obligation of Sunrise not to solicit other bids, buttressed by the commitment of Sunrise to enforce existing standstill agreements that may be in place with bidders who have already engaged in the auction process (section 4.4(1)). Secondly, it contains the "fiduciary out" protection for the Sunrise Trustees (and unitholders), permitting the Trustees to consider *bona fide* unsolicited Acquisition Proposals from third parties (*that are not in breach of the provisions of section 4.4*) (sections 4.4(2) and 4.4(3)). Thirdly, it contains a series of provisions dealing with how the parties are to address a situation where a permitted Acquisition Proposal is received (sections 4.4(3)-4.4(7)). [5] Lastly, section 4.4(8)(v) returns to the general non-solicitation obligation, reinforcing it by ensuring that Sunrise will (i) ensure all of its officers, Trustees and agents are aware of the non-solicitation provisions, (ii) immediately stop negotiating with anyone previously involved in the bidding process, (iii) require those bidders to return any confidential documentation and information they may have received during the process, (iv) terminate access to the data room by anyone other than Ventas and its representatives, and finally (a reiteration of the requirement set out in section 4.4(1)):

> (v) not amend, modify, waive or fail to enforce any of the standstill terms or other conditions included in any of the confidentiality agreements between Sunrise REIT and any third parties ...

33 Contrary to the appellants' submissions, however, it is not *any* Acquisition Proposal that the Trustees are free to consider as part of the fiduciary out scenario; it is only an Acquisition Proposal from a third party *that is not in breach of section 4.4 of the Agreement.*

34 Properly understood in this fashion, then, a reading of section 4.4 demonstrates that there is no *conflict* between the provisions of sections 4.4(1)(ii), 4.4(2), 4.4(3) and 4.4(8)(v). The repeated standstill enforcement terms *complement* one another. As the application judge pointed out, the opening phrases of sections 4.4(2) and 4.4(3) — "notwithstanding anything contained in Section 4.4(1)" — do not have the words "or Section 4.4(8)(v)" added to them. This reinforces the interpretation that section 4.4(8)(v) is there to clarify that Sunrise's obligation to enforce its Standstill Agreements with third parties is not negated by the fiduciary out clause. An unsolicited proposal by a prior bidder bound by a Standstill Agreement is a proposal that is otherwise in breach of section 4.4, because it violates section 4.4(8)(v), and therefore is not immunized by the fiduciary out provisions.

35 In that sense, contrary to the appellants' submissions, the application judge's reading of the Purchase Agreement does not reduce section 4.4(8)(v) to simply the functional equivalent of section 4.4(1)(ii). Nor is it a case of section 4.4(8)(v) continuing to require the enforcement of a Standstill Agreement even when the fiduciary out clause is otherwise applicable. The fiduciary out clause does not apply where the unsolicited proposal is tendered in breach of the non-solicitation provisions of the Purchase Agreement, i.e., in breach of a Standstill Agreement that Sunrise is obliged to enforce. The fiduciary out formula is an important feature of the non-solicitation format, but it does not allow Sunrise to resile from the terms of its Standstill Agreements with earlier bidders, in my opinion.

The Difference in Wording between Sections 4.4(1)(ii) and 4.4(8)(v)

36 Mr. Howard emphasized what he argued was a difference in wording between those two provisions. He points out that section 4.4(1)(ii) expressly refers to situations involving "an actual or potential Acquisition Proposal" whereas section 4.4(8)(v) contains no such reference, and further, that other subsections of section 4.4(8) — namely, sections 4.4(8)(ii) and (iii) — refer to Acquisition Proposals as well, although not in the context of standstill agreements (4.4(8)(ii) and 4.4(8)(iii)). Because section 4.4(8)(v) does not refer to "Acquisition Proposals", Mr. Howard submits it does not apply in the context of such a proposal and therefore does not apply in the context of the HCPI Acquisition Proposal.

37 There are several problems with this argument. First, it misapprehends the fact that *any* proposal to acquire more than twenty percent of the assets of Sunrise — whether made before or after the close of the auction — constitutes an "Acquisition Proposal" as defined in the Agreement. Consequently, section 4.4(8)(v) can only apply in the context of an Acquisition Proposal of some sort, regardless of its wording.

38 Secondly, the argument appears to be founded on the unarticulated premise that an Acquisition Proposal, as referenced in sections 4.4(1)(ii), 4.4(2) and 4.4(3), is the equivalent of a Superior Proposal. The appellants' theory of the Agreement is that the Trustees are entitled to consider any Acquisition Proposal received after the close of the auction, and that the commitment in section 4.4(8)(v) to enforce standstill agreements only applies in the event that a subsequent Acquisition Proposal received by the Trustees does not make the grade as a Superior Proposal. The function of section 4.4(8)(v), they say, is to permit the Trustees in such circumstances to prevent a bidder in such a case — whether a prior bidder or not — from continuing to participate in the bidding process.

39 It is not the case, however, that an Acquisition Proposal and a Superior Proposal are the same thing. The latter is a narrower concept than the former. While an Acquisition Proposal is essentially an offer by anyone to acquire more than twenty percent of the assets of Sunrise, a Superior Proposal is an Acquisition Proposal [6] that is more favourable to the unitholders from a financial point of view than the Ventas bid. Sunrise submits, at paragraph 43 of its factum, that section 4.4(8)(v) "is part of the filtering protection for both Ventas and Sunrise REIT that allows and obliges Sunrise REIT to deal summarily with offers that do not meet the Acquisition Proposal threshold." Sunrise does not mean the "Acquisition Proposal threshold" in this statement, however; it means the "Superior Proposal threshold." To support

the appellants' argument, the reference to "Acquisition Proposal" in section 4.4(1)(ii) would have to be read as "Superior Proposal". That is not what it says.

40 Moreover, and in any event, a careful reading of section 4.4(1)(ii) does not bear out the nexus between the reference to "Acquisition Proposal" and the commitment to enforce the standstill agreements. For ease of reference I repeat the wording of section 4.4(1)(ii) here:

> 4.4(1) Following the date hereof, Sunrise REIT shall not ...
>
> > (ii) participate in any discussions or negotiations in furtherance of such inquiries or proposals or regarding an actual or potential Acquisition Proposal or release any Person from, or fail to enforce, any confidentiality or standstill agreement or similar obligation to Sunrise REIT or any of its Subsidiaries.

41 Section 4.4(1)(ii) in reality contains two prohibitions, not one. The language does not work otherwise. Sunrise agrees not to participate in discussions or negotiations regarding actual or potential Acquisition Proposals. It also agrees not to release anyone from, or fail to enforce, existing Standstill Agreements. The drafters could well have divided section 4.4(1) into six general prohibitions rather than five. The commitment to enforce the Standstill Agreements is not, therefore, tied to "Acquisition Proposals" in a way that section 4.4(8)(v) is not.

42 Accordingly, I agree with the application judge's observation that while the appellants' interpretation arguments are creative, they are strained. As she said, "They disregard the parties' intention and the true meaning of the subject sections and the Purchase Agreement as a whole."

An Interpretation that Reflects the "Factual Matrix", is "Commercially Sensible", and Accords with the Fiduciary Obligations of the Sunrise Trustees

43 Nor do I accept the submission that the application judge failed to consider the factual matrix underlying the negotiation of the Purchase Agreement, or that she failed to give effect to the "commercial sense" component of contract interpretation.

44 In a blended argument, the appellants submit that the application judge's interpretation of the Purchase Agreement ignores the factual matrix in which the Agreement was negotiated, defies commercial sense and reasonableness, and eviscerates the fiduciary out mechanism that was central to the parties' agreement. Respectfully, I do not read the application judge's reasons in this fashion.

The Factual Matrix

45 Contracts are not made in a vacuum, and there is no dispute that the surrounding circumstances in which a contract is negotiated are relevant considerations in interpreting contracts. As this court noted in *Kentucky Fried Chicken*, *supra*, at para. 25, "[w]hile the task of interpretation must begin with the words of the document and their ordinary meaning, the general context that gave birth to the document or its 'factual matrix' will also provide the court with useful assistance."

46 Sunrise points to a number of surrounding circumstances which it says the application judge ignored in arriving at her decision. These include that:

> a) the Purchase Agreement was entered into at the conclusion of the second stage of a private sale auction process where it was clear that the overall objective of Sunrise was to maximize value for it unitholders;
>
> b) the expectations of the bidders, objectively determined, could not have been that the "winner" of the auction was assured of acquiring the Sunrise assets, because everyone was aware that there would be a fiduciary out clause and that superior proposals could displace the winning bid;

> c) Ventas's own standstill terms ceased to apply in the event that Sunrise entered into a sales transaction with a third party, and Ventas could not know whether the other Standstill Agreements rested on the same footing (and did not know that HCPI's did not);
>
> d) Ventas never told Sunrise it believed the participants in the auction would be excluded from the operation of the fiduciary out provision; and
>
> e) Ventas had bargained for, and achieved, considerable deal protection, in the form of the "no shop" provision, the right to match any Superior Proposal, and the right to receive a $39.8 million break fee if it chose not to match such an offer.

47 Matters involving the factual matrix underlying a contract are matters of fact, or at least matters of mixed fact and law. A judge is owed considerable deference in her assessment of such matters. Here, the experienced Commercial List judge was exercising a function common to that role — the interpretation of a commercial contract — and, while she may not have dealt with the foregoing themes expressly as the appellants would like, her reasons, read as a whole, indicate that she was alive to most, if not all, of them. She was certainly aware of the facts contained in points (a), (b), (c) and (e) above, as she dealt with them at one time or another in the reasons. The factor mentioned in (d) is not dispositive of anything.

48 At the conclusion of her consideration of the interpretation issue, as noted earlier, the application judge said (at paras. 38 and 39):

> 38 It seems to me that the clear scheme of this Purchase Agreement was [to] ensure enforcement of standstill agreements that had been signed as part of the auction process. This strikes me as being objectively reasonable and was a form of protection afforded to the purchaser, Ventas. This was part of the package negotiated between it and Sunrise REIT.
>
> 39 Such an interpretation derives from the words used by the parties to the Purchase Agreement and gives effect to the parties' intention. It is also consistent with the context of the transaction including the auction process which was the genesis of the Purchase Agreement. The Purchase Agreement does not preclude bona fide written unsolicited Acquisition Proposals nor does it preclude such a proposal from a party whose standstill agreement operated to permit such a proposal. It simply precludes a proposal from anyone else who is in breach of its standstill agreement. [Emphasis added, footnote omitted.]

49 I can find no basis for concluding the applications judge was not attuned to the need to keep the factual matrix in mind when conducting her interpretative exercise.

50 Nor do I accept that she either ignored the need to interpret the contract in a way that reflected sound commercial sense, or that she failed to give it such an interpretation. It is apparent from her recitation of the principles of contract interpretation that she was aware of the relevance of the "sound commercial sense" theme. She cited the following passage from this Court's decision in *Kentucky Fried Chicken*, *supra*, at para. 27:

> Where, as here, the document to be construed is a negotiated commercial document, the court should avoid an interpretation that would result in a commercial absurdity: [*City of Toronto v. W.H. Hotel Ltd.* (1966), 56 D.L.R. (2d) 539 at 548 (S.C.C.)]. Rather, the document should be construed in accordance with sound commercial principles and good business sense: [*Scanlon v. Castlepoint Development Corporation et al.* (1992), 11 O.R. (3d) 744 at 770 (Ont.C.A.)]. Care must be taken, however, to do this objectively rather than from the perspective of one contracting party or the other, since what might make good business sense to one party would not necessarily do so for the other.

51 The appellants' argument that the application judge failed to interpret the Purchase Agreement in a fashion that accords with sound commercial sense is grounded in the belief that she overlooked the importance of the "maximizing

value" principle and the centrality of the Trustees' fiduciary obligations in that regard, in cases of this nature. She did neither, in my view.

52 As noted above, the application judge was sensitive to the fiduciary out provisions that permitted other *bona fide* written unsolicited Acquisition Proposals. In her view, however, this was balanced, objectively and reasonably, by the requirement that Sunrise ensure enforcement of Standstill Agreements that had been signed as part of the auction process in order to protect the successful bidder. This interpretation makes commercial sense, in my view.

53 On behalf of HCPI, Mr. Leon placed great emphasis on the sanctity of the fiduciary out mechanism in acquisition agreements of this nature. There is no doubt that the directors of a corporation that is the target of a takeover bid — or, in this case, the Trustees — have a fiduciary obligation to take steps to maximize shareholder (or unitholder) value in the process: see *CW Shareholdings Inc. v. WIC Western International Communications Ltd.* (1998), 39 O.R. (3d) 755 (Ont. Gen. Div. [Commercial List]), at 768 and 774. That is the genesis of the "fiduciary out" clauses in situations such as the case at hand. They enable directors or trustees to comply with their fiduciary obligations by ensuring that they are not precluded from considering other *bona fide* offers that are more favourable financially to the shareholders or unitholders than the bid in hand.

54 It is not necessary — nor would it be wise, in my view — to go as far as HCPI suggests this court might go, and adopt the principle gleaned from some American authorities, that the target vendor can place no limits on the directors' right to consider superior offers and that any provision to the contrary is invalid and unenforceable: see *Paramount Communcations Inc. v. QVC Network Inc.*, 637 A.2d 34 (U.S. Del. Super. 1994), and *ACE Ltd. v. Capital Re Corp.*, 747 A.2d 95 (U.S. Del. Ch. 1999) at 105. That is not what happened in this case.

55 The Trustees did not contract away their fiduciary obligations. Rather, they complied with them by setting up an auction process, in consultation with their professional advisers, that was designed to maximize the unit price obtained for Sunrise's assets, in a fashion resembling a "shotgun" clause, by requiring bidders to come up with their best price in the second round, subject to a fiduciary out clause that allowed them to consider superior offers from anyone save only those who had bound themselves by a Standstill Agreement in the auction process not to make such a bid. In this case, that turned out to be only HCPI.

56 An auction process is well-accepted as being one — although only one — "appropriate mechanism to ensure that the board of a target company acts in a neutral manner to achieve the best value reasonably available to shareholders in the circumstances": *Pente Investment Management Ltd. v. Schneider Corp.* (1998), 42 O.R. (3d) 177 (Ont. C.A.) at 200. Here, the trustees, acting reasonably and on professional advice, formed the view that an auction process was the best way to maximize value, and conducted such an auction to the point where they attracted a successful bidder. This is not a case where the Trustees were unable to judge the adequacy of the bid (*Schneider*, at 200). They had dealt with seven prospective purchasers in the course of the two auction rounds, and had received preliminary proposals. Ventas's $15.00-per-unit price represented a 35.8% increase over the market price of the Units on the date the auction closed. I do not think the Trustees can be said to have failed in the exercise of their fiduciary obligations to their unitholders in these circumstances simply by agreeing in the Purchase Agreement to preclude earlier bidders, who had bound themselves under Standstill Agreements not to do so, from coming in after the auction was concluded and the "successful" bidder had showed its cards and attempting to "top up" that bid.

57 It is well accepted that "where an agreement admits of two possible constructions, one of which renders the agreement lawful and the other of which renders it unlawful, courts will give preference to the former interpretation": John D. McCamus, *The Law of Contracts* (Toronto: Irwin Law, 2005) at 729. Advancing this principle, the appellants argue that we should be loathe to adopt an interpretation of the Purchase Agreement that is inconsistent with overarching fiduciary obligations. While I accept the principle put forward, however, I do not think it applies in the context of this case for the reasons outlined above. The interpretation given to the Purchase Agreement by the application judge is not inconsistent with the Trustee's fiduciary obligation to maximize unitholder value. Indeed, it is consistent with that obligation.

58 Finally, Mr. Leon emphasizes the importance of the word "nothing" in the opening language of sections 4.4(2) and 4.4(3) of the Purchase Agreement. Both provisions open with the words "Notwithstanding anything contained in Section 4.4(1), until the Unitholder Approval, *nothing* shall prevent the Board from ..." [emphasis added]. Mr. Leon submits that "nothing" means what it says, and must be given the full scope of that meaning, in order to ensure that "nothing" in the Purchase Agreement or otherwise is permitted to stand in the way of the Trustees performing their duty to maximize shareholder value. This point involves parsing the Purchase Agreement in a microscopic fashion that is a little too fine, in my view. The use of the word "nothing" in sections 4.4(2) and 4.4(3) is nothing more than a different way of saying "Notwithstanding anything contained in Section 4.4(1) ... *the Board is not prevented from* ...". I would not ascribe to it the expanded role that HCPI proposes.

The Meaning of "Bona Fide"

59 The appellants also attack the conclusion of the application judge that the HCPI Acquisition Proposal was not a "*bona fide*" offer. She accepted the Ventas submission that "a proposal made in breach of a contractual obligation not to make such a proposal cannot be considered to be *bona fide*," noting that sections 4.4(2) and 4.4(3) of the Purchase Agreement contemplate an Acquisition Proposal from a third party "that did not result from a breach of ... Section 4.4".

60 There was much debate about the meaning of "*bona fide*". The application judge viewed it as meaning acting "in good faith; sincere, genuine", relying upon *The Oxford English Dictionary*.[7] She found that the HCPI Acquisition Proposal was not *bona fide* because it was made in breach of the HCPI Standstill Agreement, which Sunrise was obliged by s. 4.4 to enforce. The appellants agree that *bona fide* means "genuine" or "made in good faith" but submit that a *bona fide* Acquisition Proposal, as contemplated by the Purchase Agreement, is one that is "genuine" or "authentic" in the sense that it is not a sham and is reasonably capable of becoming a Superior Proposal, and that this decision must be made in the context of the entire situation.

61 In the end, there is not much difference between the parties as to the meaning of the term "*bona fide*". As with the principles of contract interpretation, they differ on the application of the term in the circumstances of this case. Given the language of the Purchase Agreement, and the context in which it was negotiated — particularly the language "that did not result from a breach of this Section 4.4" in sections 4.4(2) and 4.4(3) — I do not think the application judge erred in her assessment and use of the term "*bona fide*" here.

Miscellaneous

62 Two additional points were made by the appellants, but need not be dealt with at length.

63 First, HCPI argued that Sunrise had given its prior consent to HCPI to make its subsequent Acquisition Proposal following completion of the auction process and the execution of the Purchase Agreement. This consent is said to derive from the waiver Sunrise gave to both HCPI and Ventas as part of the invitation to bid in the second round. The application judge made a specific finding against this position, however, concluding that the December 29, 2006 letter "cannot possibly be construed as constituting Sunrise REIT's prior written consent as that term is used in the Standstill Agreement." There is no basis for interfering with this finding.

64 Secondly, HCPI submitted that the position of Ventas on these applications was tantamount to saying that the benefit of the HCPI Standstill Agreement had been assigned to it. The application judge correctly found that there was no merit in this argument. I agree with her that neither the Standstill Agreement nor its benefits had been assigned to anyone, and no one was taking the position that they had.

The HCPI Cross-Appeal

65 HCPI applied for a declaration that communications between it and SSL regarding Sunrise were permitted. The application judge declined to deal with this request, given her ruling which effectively precluded the HCPI Acquisition Proposal from being pursued. She concluded the application was moot.

66 I agree and for the same reason find it unnecessary to deal with the cross-appeal for the same relief.

Conclusion

67 For the foregoing reasons, then, I would dismiss both the appeal and the cross-appeal.

68 If the parties are unable to agree as to costs, they may make brief written submissions in that regard, not to exceed five pages in length.

69 In closing, I would like to thank all counsel for their able presentations and assistance.

J. MacFarland J.A.:

I agree.

H.S. LaForme J.A.:

I agree.

Appeal dismissed; cross-appeal dismissed.

Footnotes

1 *BG Checo International Ltd. v. British Columbia Hydro & Power Authority*, [1993] 1 S.C.R. 12 (S.C.C.) at 23-24; *Scanlon v. Castlepoint Development Corp.* (1992), 11 O.R. (3d) 744 (Ont. C.A.) at 770.

2 *Toronto Dominion Bank v. Leigh Instruments Ltd. (Trustee of)* (1998), 40 B.L.R. (2d) 1 (Ont. Gen. Div. [Commercial List]) at para. 403, aff'd (1999), 45 O.R. (3d) 417 (Ont. C.A.); *Venture Capital USA Inc. v. Yorkton Securities Inc.* (2005), 75 O.R. (3d) 325 (Ont. C.A.) at para. 26; *Eli Lilly & Co. v. Novopharm Ltd.*, [1998] 2 S.C.R. 129 (S.C.C.) at 166-68 [*Eli Lilly*].

3 *Eli Lilly*, *ibid.* at 166; *Kentucky Fried Chicken Canada v. Scott's Food Services Inc.* (1998), 114 O.A.C. 357 (Ont. C.A.) at paras. 25-27 [*Kentucky Fried Chicken*].

4 *Consolidated-Bathurst Export Ltd. c. Mutual Boiler & Machinery Insurance Co.* (1979), [1980] 1 S.C.R. 888 (S.C.C.) at 901; *Kentucky Fried Chicken*, *ibid.*

5 The Proposal has to be a Superior Proposal; Sunrise has to notify Ventas of the Proposal and provide it with all relevant documentation; Ventas had the right to match the Proposal within five days (as defined) and, if it chooses not to, to terminate the Agreement and receive the break fee (see also, section 5.3 and Schedule "B" (definition of "Termination Payment")).

6 That meets the section 4.4(2) requirements of being *bona fide* and unsolicited.

7 2d ed., *s.v.* "bona fide".

TAB 28

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Jakub Adamski

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may sometimes be easy to say that an individual bargain is on one side of the line or the other, but very difficult to say where the line should be drawn.[223]

9.2.5.1 Unconscionability in Transactions

§9.100 There exists no general power in the courts to protect people from improvident or foolish bargains and the doctrine of unconscionability has never attempted to do so. As has been mentioned, the difficult question for the law is to find a basis for giving relief in those cases where it is necessary to do so and in describing what factors will indicate that relief should be given.[224]

§9.101 While the kind of guidance that the courts should be expected to provide may not often be relied on by solicitors drafting contracts — they will for the most part want to keep their clients far from the border, though bank guarantees are, for obvious reasons an exception — it will be relied on by other courts and, when problems have arisen, in helping any lawyers involved reach a settlement. The doctrine of unconscionability can be regarded as a general tool[225] to be used when more specialized tools cannot be used. In this sense, like the category of

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province, reflects the settled principle that commercial agreements between businessmen should not, in the absence of fraud, duress, undue influence, or misrepresentation, be set aside on grounds of unconscionability."

223 There are many, mostly historical cases where the question was whether one party had an obligation to disclose to the other information the first party had about the transaction. One of the most famous of these is *Laidlaw v. Organ*, 15 U.S. (2 Wheat.) 178 (1817), where a buyer of tobacco did not disclose to his seller that the blockade of New Orleans would shortly be lifted, causing a major rise in the price of tobacco. The United States Supreme Court held the seller bound to the terms of the deal unless the buyer had lied to him as opposed to keeping silent. Questions like these are much less likely to arise now because of the much more rapid dissemination of news. With respect to non-disclosure by sellers, it is important to keep in mind the fact that the buyer's solicitor will usually draft the first version of any agreement of purchase and sale and is likely to require the seller to make some disclosure of facts which might be material, perhaps limited to the seller's "knowledge" or "to the best of the seller's knowledge". Provincial *Securities Acts* deal with many of these issues in sales of securities by statutory requirements of disclosure. For a survey of the issues from a philosophical perspective, see Marc Ramsay, "The Buyer/Seller Asymmetry: Corrective Justice and Material Non-Disclosure" (2006), 56 U.T.L.J. 115. See also the cases examined in §4.30, sections 4.1.1.4.1 and 4.2.1.1.1, above.

224 In *Murray v. Affordable Homes Inc.*, 2007 BCSC 1428, 61 R.P.R. (4th) 304, [2007] B.C.J. No. 2097 (B.C.S.C.) the plaintiff, who was in default under her mortgage, was conned by the defendant into selling her property and leasing it back from an "investor". When she was late in making three payments under the lease, she was threatened with eviction. After a comprehensive condemnation of the defendant's conduct, the sale was set aside on the basis of fraud, unconscionability, undue influence and breach of the *Business Practices and Consumer Protection Act*, S.B.C. 2004, c. 2. It is apparent from the reasons for judgment that the trial judge was sufficiently outraged by the defendant's conduct that she was prepared to find for the plaintiff on any available basis.

225 In *Ryan v. Moore*, 2005 SCC 38, [2005] 2 S.C.R. 53, 254 D.L.R. (4th) 1, 247 Nfld. & P.E.I.R. 286, [2005] S.C.J. No. 38, at para. 74 (S.C.C.), Bastarache J. suggested that the word "unconscionable" should be confined to cases of unequal bargaining power and not used, *e.g.*, in cases — as in the case before him — where the issue was whether a defendant was estopped from relying on a *Limitations Act* defence.

TAB 29

2007 ANNREVINSOLV 3

Annual Review of Insolvency Law

Annual Review of Insolvency Law 2007 Editor: Janis P. Sarra

Madam Justice Georgina Jackson and Janis Sarra

3 — Selecting the Judicial Tool to get the Job Done: An Examination of Statutory Interpretation, Discretionary Power and Inherent Jurisdiction in Insolvency Matters

3 — Selecting the Judicial Tool to get the Job Done: An Examination of Statutory Interpretation, Discretionary Power and Inherent Jurisdiction in Insolvency Matters

Madam Justice Georgina R. Jackson and Dr. Janis Sarra. [1]

I. — Introduction

The judicial tools used by Canadian courts to advance the enabling objectives of corporate commercial law, and in particular, insolvency law, are the focus of this paper. We address the recurring case where an insolvent corporation, creditor or other interested party asks a court to apply or extend the terms of legislation to circumstances not previously contemplated. A number of tools have been used by the courts to meet the evolving needs of corporate commercial law. These tools include: statutory interpretation, both in determining the extent of judicial authority and the basis of any exercise of judicial discretion to decide a particular case or grant a particular remedy; the gap-filling power of judges; the common law or the evolution of the common law to meet modern cases; equitable jurisdiction; and inherent jurisdiction. We examine the nature of these tools and their appropriate use in the insolvency law context.

The paper advances the thesis that in addressing the problem of under-inclusive or skeletal legislation, there is a hierarchy or appropriate order of utilization of judicial tools. First, the courts should engage in statutory interpretation to determine the limits of authority, adopting a broad, liberal and purposive interpretation that may reveal the authority. We suggest that it is important that courts first interpret the statute before them and exercise their authority pursuant to the statute, before reaching for other tools in the judicial toolbox. Examination of the statutory language and framework of the legislation may reveal a discretion, and statutory interpretation may determine the extent of the discretion or statutory interpretation may reveal a gap. The common law may permit the gap to be filled; if it does, the chambers judge still has a discretion as to whether he or she invokes the authority to fill the gap. The exercise of inherent jurisdiction may fill the gap; if it does, the chambers judge still has a discretion as to whether he or she invokes the authority revealed by the discovery of inherent jurisdiction. This paper considers these issues at some length.

In the past 25 years, we have seen a burgeoning interest in the judicial role in the economy. The resolution of commercial disputes through judicial pronouncements has facilitated commercial activity in Canadian society, and the courts' willingness to recognize the need for practical, effective and expeditious proceedings has been a hallmark of recent developments. One of the first Canadian pronouncements to note and speak of this new reality comes from Saskatchewan on an application to lift the stay on a judgment obtained in a contracts case. Tallis J.A. wrote:

> [10] I am of the opinion that recent authorities in Western Canada display a willingness to re-examine the older authorities in the light of modern economic conditions and commercial practices: vide *Rockwood Enterprises Ltd. v. Grain Ins. & Guar Co.*, [1980] M.J. No. 20, [1980] 4 W.W.R. 319; *Powell v. Guttman*, [1977] M.J. No. 3, [1977] 6 W.W.R. 106; *Robitaille v. Vancouver Hockey Club Ltd.*, [1980] B.C.J. No. 872; (1981), 26 B.C.L.R. 1; *Morrison-Knudsen Co. v. B.C. Hydro & Power Authority* (March 15, 1976) (B.C.C.A.) (unreported). [2]

Words similar to these have been repeated in different commercial contexts. In the proceeding under the *Companies' Creditors Arrangement Act*[3] (CCAA) in *Re Canadian Airlines*, Paperny J., as she then was, observed:

> [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.[4]

In similar vein, appellate courts have recognized the speed at which commercial courts must act to be of assistance in restructuring cases and have expressed a willingness to defer to the expertise of specialized divisions of the courts. Rosenberg J.A., speaking for the Ontario Court of Appeal in *Algoma Steel Inc. v. Union Gas Ltd.*, expressed it the following way:

> [16] . . . Decisions in the CCAA context must often be made quickly. They are, as in this case, usually made by a judge with considerable expertise in the area who has been managing the CCAA proceedings and is intimately familiar with the context and the issues at stake.[5]

The same Court, this time under the pen of Blair J.A., referred again in *Re Stelco Inc.* to the need to defer to the commercial expertise of the trial courts:

> [63] There is no question that the decisions of judges acting in a supervisory role under the CCAA, and particularly those of experienced commercial list judges, are entitled to great deference: see *Algoma Steel Inc. v. Union Gas Ltd.* (2003), 63 O.R. (3d) 78, [2003] O.J. No. 71, ¶16 (C.A.). The discretion must be exercised judicially and in accordance with the principles governing its operation.[6]

This rise of interest and flexibility in commercial matters raises the question of whether there is something unique about commercial law. Professor D.J. Galligan would answer no. It is not a phenomenon unique to commercial law. He writes:

> There is nothing new about courts changing the law, but it has become of particular interest in recent years, since a number of jurists have detected a widespread tendency whereby existing legal doctrines are being replaced by rather loosely defined standards, which are to be applied according to the merits of particular cases. G.H. Treitel has provided a perceptive analysis of this trend in the law of contract, and similar movements can be seen in various aspects of administrative law, the law of evidence, and, undoubtedly, in any area of modern law.[7]

Professor Galligan sees this phenomenon "as part of a general progression within modern legal systems away from clear and certain rules, towards more discretionary decision-making".[8]

Notwithstanding the recognition given to changes in approach in the law, and the courts' willingness to give effect to these changes, the effort by Canadian courts to provide helpful assistance to advance commercial activity and commercial relationships has not been without its growing pains. Specifically, where the court is faced with pleadings, evidence and submissions that point to a particular appropriate result, the courts have sometimes struggled with the basis of their authority where the statute has not expressly addressed an issue. Interpretation of the CCAA is a quintessential example of this practice, although it also occurs to a lesser degree under the *Bankruptcy and Insolvency Act*[9] (BIA) and other insolvency or corporate statutes.

This paper commences an important and timely discussion regarding the need to articulate more clearly the basis for exercising the court's authority in insolvency matters, a debate that will require considerably more discussion before it is fully resolved. In the course of writing this paper, the authors have had lively discussion in respect of the precise contours of the various tools, and in particular, inherent jurisdiction, a conversation that is continuing.

We advance several propositions in this paper that we hope will facilitate a thoughtful debate regarding the exercise of judicial authority in insolvency and other commercial cases. First, we suggest that it may be useful to consider the tools available, as if in a hierarchy, commencing with the need to exhaust the interpretive tools before considering questions of jurisdiction. By determining first whether the legislation can bear a broad and liberal interpretation, judges may avoid the difficulties associated with the exercise of inherent jurisdiction. The statute, appropriately construed, may reveal both a discretionary power and the limits to be placed on that discretion without resort to inherent jurisdiction.

Second, we suggest that inherent jurisdiction is a misnomer for much of what has occurred in decision making under the CCAA. Appeal court judgments in cases such as *Skeena Cellulose Inc.*, [10] and *Stelco*, [11] discussed below, have begun to articulate this view. As part of this observation, we suggest that for the most part, the exercise of the court's authority is frequently, although not exclusively, made on the basis of statutory interpretation.

Third, in the context of commercial law, a driving principle of the courts is that they are on a quest to do what makes sense commercially in the context of what is the fairest and most equitable in the circumstances. The establishment of specialized commercial lists or rosters in jurisdictions such as Ontario, Québec, British Columbia, Alberta and Saskatchewan are aimed at the same goal, creating an expeditious and efficient forum for the fair resolution of commercial disputes effectively and on a timely basis. Similarly, the standards of review applied by appellate courts, in the context of commercial matters, have regard to the specialized expertise of the court of first instance and demonstrate a commitment to effective processes for the resolution of commercial disputes.

Fourth, we suggest that courts need to articulate the basis of their authority in their judgments better, and to be as specific as possible on the source of the authority. It is important to draw a clear distinction between the court's exercise of power pursuant to the statute and the exercise of inherent jurisdiction. Why is it necessary to articulate the basis of power that courts exercise with greater precision? There are several reasons. The courts have sometimes inappropriately conflated inherent jurisdiction and the exercise of judicial discretion in their reasoning, often relying on both grounds of authority in one sentence in rendering a decision in the commercial context. This conflation can create uncertainty for parties in terms of their understanding of the principles or rationale underlying a judgment of the court. In turn, this failure to articulate clearly the source of authority has implications for future cases, particularly where the authority exercised lacks predictability or certainty. Moreover, counsel in subsequent cases may fail to take the time to articulate the authority on which they rely for a particular remedy, given the existence of prior judgments in which the court has failed to articulate the basis of its authority properly.

Courts of first instance need to have a clear understanding of the basis of the decision, in part because the judgment creates a precedent that other courts will embrace. Even where the statutory framework grants the court discretionary powers, the use of precedent narrows the scope of the court's discretion in future cases through the desire to create consistency and certainty in the case law — a narrowing that will be enforced by an appellate court in an appropriate case notwithstanding the characterization of the decision as being discretionary, as discussed in Part III below.

The failure to pin down precisely the basis of the exercise of the court's authority has implications for appellate review. Appellate courts are more likely to accord deference to the appropriate exercise of discretion granted under a statute. Where inherent jurisdiction is invoked, appellate courts are more likely to scrutinize the basis of the lower court's authority and whether it advances the principles that have been articulated for the use of inherent jurisdiction as a gap-filling technique.

To accomplish the task of articulating the basis of decision making better, judges must tighten the language they utilize. For example, when judges make a determination pursuant to a statute, they are exercising their power or authority, not their discretion. There may be an element of choice, particularly when the courts are choosing from a range of remedies, but for the most part, their judgment is based on their authority to resolve the dispute and should be articulated as such. This clarity will assist with the transparency and certainty of their decisions, a benefit for the parties before them and of assistance to the appellate court in engaging in any review. This approach means that the court must first examine the statute and construe its terms having regard for all of the statutory interpretive rules applicable. It may be that the object and purpose of the statute confer an implicit power or it may be that there is a gap-filling role to be played in the circumstances. If so, is the court filling the gap through use of the common law or its inherent jurisdiction? Where any of these tools are utilized, the court must draw on the purpose of the statutory regime in order to determine what is fair, just and commercially reasonable in the circumstances. If there is not a gap-filling role, the courts are to apply the law, as the Supreme Court of Canada directed in *GMAC Commercial Credit Corp. — Canada v. TCT Logistics Inc.*, discussed below. [12]

The remainder of this paper explores these ideas using the reasoning by Canadian courts to date, as well as scholarly commentary on the nature and scope of statutory interpretation, inherent jurisdiction, and judicial discretion. Part II introduces statutory interpretation and the gap-filling power of judges. Part III considers judicial discretion flexibly applied in commercial matters. Part IV examines the use of inherent jurisdiction in Canadian insolvency law cases. Finally, Part V concludes with some thoughts about how courts might consider the exercise of their power in the future.

II. — Statutory Interpretation and the Gap-Filling Power of Judges

It is important to commence with a discussion of general principles of statutory interpretation. These principles apply to commercial law cases as much as they do to more directly remedial legislation, yet one does not often see these principles articulated in many commercial law judgments, in part because of the need for expeditious answers to time-sensitive questions, notwithstanding that the principles are frequently the operating principles being applied by the court.

In a paper such as this, one cannot hope to do justice to a review of the major works pertaining to statutory interpretation. We have confined ourselves to citing extensively from two Canadian texts: *Sullivan and Driedger on the Construction of Statutes* [13] and *The Interpretation of Legislation in Canada.* [14] In doing so, we also recognize that we cannot resolve the debate about how courts should construe statutory instruments.

Under-inclusive or skeletal legislation can be addressed in a variety of ways by the courts. It can, for example, be considered as an aspect of the application of Driedger's Modern Principle and purposive legislative construction or as gap-filling as a distinct statutory interpretation technique known to the common law. We will address these in turn.

A. — Driedger's Modern Principle as an Aspect of Purposive Legislative Construction

The first formulation of the Modern Principle taken from the second edition of Driedger's text, and cited most frequently by the Supreme Court of Canada, is this:

> Today there is only one principle or approach, namely, the words of an Act are to be read in their entire context, in their grammatical and ordinary sense harmoniously with the scheme of the Act, the object of the Act, and the intention of Parliament. [15]

We acknowledge the debate surrounding the ambit and use of the Modern Principle in Canada in respect of whether it is used by the court as a means of finding meaning or as a means to justify the meaning selected; and even as to which of the statements of the Principle govern interpretation in Canada, as discussed by both Professors Sullivan [16] and Côté, [17] and more recently, by Professors Coté and Beaulac. [18] However, it is a discussion we need not enter fully. Our concern is not with ambiguous legislation or legislation whose terms do not accord with its stated or implied objects, where the

controversy is most acute, but rather with legislation that is skeletal, granting broad powers to the courts in general terms. The Modern Principle is a tool for construing such legislation.

The utility of the Modern Principle in construing under-inclusive insolvency legislation is best illustrated by the Supreme Court's support for its formulation in *Rizzo & Rizzo Shoes Ltd.* [19] Canadian courts cite *Rizzo* regularly to aid in the interpretation of all legislation, federal and provincial, but it is useful to remember that *Rizzo* is a case emanating from a failed company seeking resolution in bankruptcy. The application of the Modern Principle to the facts of the *Rizzo* decision demonstrate its usefulness in considering legislation like the BIA and the CCAA.

In *Rizzo* the Court was asked to construe these sections of Ontario's *Employment Standards Act* (ESA): [20]

> 40.
> —
>
> (1) No employer shall terminate the employment of an employee who has been employed for three months or more unless the employer gives [notice according to a certain schedule] and such notice has expired.
>
> . . . . .
>
> (7) Where the employment of an employee is terminated contrary to this section,
>
> (a) the employer shall pay termination pay in an amount equal to the wages that the employee would have been entitled to receive at his regular rate for a regular non-overtime work week for the period of notice prescribed by subsection (1) or (2), and any wages to which he is entitled;
>
> 40a.
> . . .
>
> (1a) Where,
>
> (a) fifty or more employees have their employment terminated by an employer in a period of six months or less and the terminations are caused by the permanent discontinuance of all or part of the business of the employer at an establishment;
>
> . . . . .
>
> the employer shall pay severance pay to each employee whose employment has been terminated and who has been employed by the employer for five or more years.

In the case before the Court, the employees lost their jobs because their employer had been put into bankruptcy. The issue was whether the loss of employment caused by the bankruptcy of an employer gave rise to a claim provable in bankruptcy for termination pay and severance pay in accordance with the provisions of employment standards legislation. The Ontario Court of Appeal concluded that the provisions of the ESA could not be interpreted or extended to include employees in such a situation. The Supreme Court of Canada unanimously disagreed.

Iacobucci J., writing for the Court in *Rizzo Shoes*, reaffirmed Driedger's Modern Principle as the best approach to interpretation of the legislation and stated that "statutory interpretation cannot be founded on the wording of the legislation alone". [21] He considered the history of the legislation and the benefit-conferring nature of the legislation and examined the purpose and object of the Act, the nature of the legislation and the consequences of a contrary finding, which he labeled an absurd result. [22] Iacobucci J. also relied on s. 10 of the *Interpretation Act*, which provides that every Act "shall be deemed to be remedial" and directs that every Act "shall accordingly receive such fair, large and liberal

construction and interpretation as will best ensure the attainment of the object of the Act according to its true intent, meaning and spirit". [23] The Court held:

> 23 Although the Court of Appeal looked to the plain meaning of the specific provisions in question in the present case, with respect, I believe that the court did not pay sufficient attention to the scheme of the ESA, its object or the intention of the legislature; nor was the context of the words in issue appropriately recognized. I now turn to a discussion of these issues.
>
> . . . . .
>
> 40 As I see the matter, when the express words of ss. 40 and 40a of the ESA are examined in their entire context, there is ample support for the conclusion that the words "terminated by the employer" must be interpreted to include termination resulting from the bankruptcy of the employer. Using the broad and generous approach to interpretation appropriate for benefits-conferring legislation, I believe that these words can reasonably bear that construction.

Thus, in *Rizzo Shoes* we see the Court extending the legislation or making explicit that which was implicit only, as it were, by reference to the Modern Principle, the purpose and object of the Act and the consequences of a contrary result. No reference is made to filling the legislative gap, but rather, the Court is addressing a fact pattern not explicitly contemplated by the legislation and extending the legislation to that fact pattern.

Professor Côté also sees the issue of legislative gaps as part of the discussion of "legislative purpose", which finds expression in the codification of the mischief rule by the various Canadian interpretation statutes. [24] The ability to extend the meaning of the provision finds particular expression when one considers the question posed by him: "can the purposive method make up for lacunae in the legislation". [25] He points out, as does Professor Sullivan, that the courts have not provided a definitive answer, but that for him there are two schools of thought. [26] One draws on the "literal rule", which favours judicial restraint, whereas the other, the "mischief rule", "posits correction of the text to make up for lacunae". [27] To temper the extent of the literal rule, Professor Coté states:

> *First, the judge is not legislating by adding what is already implicit. The issue is not the judge's power to actually add terms to a statute, but rather whether a particular concept is sufficiently implicit in the words of an enactment for the judge to allow it to produce effect, and if so, whether there is any principle preventing the judge from making explicit what is already implicit.* Parliament is required to be particularly explicit with some types of legislation such as expropriation statutes, for example.
>
> Second, the Literal Rule suggests that as soon as the courts play any creative role in settling a dispute rather than merely administering the law, they assume the duties of Parliament. But by their very nature, judicial functions have a certain creative component. If the law is silent or unclear, the judge is still required to arrive at a decision. In doing so, he [she] may quite possibly be required to define rules which go beyond the written expression of the statute, but which in no way violate its spirit.
>
> In certain situations, the courts may refuse to correct lacunae in legislation. This is not necessarily because of a narrow definition of their role, but rather because general principles of interpretation require the judge, in some areas, to insist on explicit indications of legislative intent. It is common, for example, for judges to refuse to fill in the gaps in a tax statute, a retroactive law, or legislation that severely affects property rights. [28] [Emphasis added. Footnotes omitted.]

This reasoning has particular significance when one considers the CCAA, which will be discussed more fully later in this paper.

As Professor Sullivan indicates, "[t]he modern principle emphasizes the importance of purposive analysis in statutory interpretation". [29] She goes on to say "[a]n important use of purposive analysis is to help establish the scope of the powers and discretions conferred by statute on government officials and agencies as well as independent bodies and tribunals". [30] She cites *Bell Canada v. Canadian Radio-Television & Telecommunications Commission* for this proposition. [31] In *Bell Canada*, the Court found that the power to make revisions and the power to order rebates are a necessary adjunct to the power to make interim orders. [32] Much of what courts do in insolvency law cases is determine the scope of their own powers and that of the officers they appoint. Purposive analysis can help determine that scope.

Professor Côté observes that the application by the courts of the mischief rule is on the increase while the grammatical method is on the decline. [33] He places the discussion in historical context and also explains the present approach in terms of Driedger's "one principle" of statutory interpretation:

> In the sixteenth and the seventeenth centuries, the purposive method, then known as "equitable interpretation", was well accepted. The Mischief Rule of *Heydon's Case* gave the judge wide latitude to adjust the statute to the circumstances of each case. It attributed little moderating effect to the text itself. In the eighteenth century, theories of strict interpretation led to an extremely prolix drafting style. Associated with the doctrine of parliamentary sovereignty and the separation of legislature and judiciary, this phenomenon led to the blossoming of literal interpretation, and its ascendancy throughout the nineteenth century. Since then, the purposive approach has been revived, at the expense of the grammatical method. The pendulum seems now to be about midway between the two. As Professor Driedger wrote:
>
> > To-day there is only one principle or approach, namely, the words of an Act are to be read in their entire context in their grammatical and ordinary sense harmoniously with the scheme of the Act, the object of the Act and the intention of Parliament. [34]

Quoting Alain-Francois Bisson, Professor Côté states that "all interpretation, whether we realize it or not, is fundamentally oriented towards the purpose of the statute". [35] He lists the factors that help to explain why some courts will favour the spirit of the law in some cases, and the letter of the law in others. [36] In considering insolvency legislation, this observation is pertinent:

> Drafting style can influence the relative weight accorded the letter and the spirit of the law. A meticulous, detailed drafting will by its very nature invite a literal interpretation. The main principles of the statute become difficult to discern. Because the legislature is supposed to have thought of everything, the court is discouraged from adding or removing terms, or speculating about their purpose. *A contrario*, if drafted in general terms, a statute's goals, structure and principles are more accessible. The judge is inspired to cooperate in its implementation. More emphasis is placed on the aim of the legislation.

Professor Côté indicates that the purposive or teleological method, which is what he prefers to call it, may take a variety of forms: (i) to correct obvious material errors; (ii) to remove uncertainty about the meaning of a provision; and (iii) to limit or extend the meaning of a provision. [37]

B. — The Common Law "Gap-filling" Power

Whereas Professor Côté in his text considers gap-filling as an aspect of purposive interpretation, [38] Professor Sullivan discusses gap-filling in a separate chapter entitled "Plausible Meaning, Mistakes and Gaps". [39] She would see a distinction between giving legislation a broad interpretation and gap-filling. [40] Professor Sullivan suggests that there is no general jurisdiction to fill gaps in legislative schemes, but it is a tool the courts resort to in certain circumstances. [41] She divides

the cases into: (i) decisions where the judicial response has been "courts have no jurisdiction to disregard the intentions of the legislation, however ill-considered these intentions may be" and "courts have no jurisdiction to cure under-inclusive provisions or gaps in legislative schemes";[42] and (ii) decisions where courts have chosen to "supplement under-inclusive provisions by relying on the common law, including, in particular, their inherent jurisdiction".[43] In taking this second route, courts give effect to the principle: "if an activity has been subjected to regulation by the legislature, courts are obligated to make the scheme work".[44]

Professor Sullivan mentions what she calls the "new, more co-operative approach" as articulated by Lord Denning dissenting in *Magor and St. Mellons Rural District Council v. Newport Corp.*:[45]

> We do not sit here to pull the language of Parliament and of Ministers to pieces and make nonsense of it. That is an easy thing to do, and it is a thing to which lawyers are too often prone. We sit here to find out the intention of Parliament and of Ministers and carry it out, and we do this better by filling in the gaps and making sense of the enactment than by opening it up to destructive analysis.

She observes that the attitude expressed in this passage is echoed by Canadian courts, and cites as an example, *Air Canada v. British Columbia*, a taxation powers case.[46] Professor Sullivan indicates that judges do not always articulate the basis on which they are filling a legislative gap, but when judges fill gaps, they will either do so expressly or they will invoke the common law, and in particular the inherent jurisdiction of courts, to supplement under-inclusive legislation or otherwise fill gaps.[47]

When one consults the other major Canadian statutory interpretation text, there is no consideration of inherent jurisdiction at all, let alone as a gap-filling technique.[48] Indeed, the words "inherent jurisdiction" cannot be found in the index. The civilist's approach to filling gaps is outlined thusly:

> Approaching the question of filling lacunae is different in civil law. At common law, when a judge refuses to fill the void of a statute, it is implicitly understood that the situation not covered by the statute is to be resolved through the *jus commune*, which is the common law. However, in Québec the *Civil Code* and the *Code of Civil Procedure* constitute, for their respective subject matters, elements of the *jus commune*. If a strict interpretation was to be afforded them, situations which are not expressly foreseen might fall into the proverbial "judicial void". Evidently, it is expected of a judge to interpret a civil law provision so as to fill these gaps either by the analogous extension of the rules it contains or by recourse to principles induced from specific provisions of the codes. Indeed, the Preliminary Provision of the *Civil Code* recommends that interpreters apply the Code by referring to the general principles of law and by not limiting themselves to the letter of the law, but also seeking its spirit and object.[49]

By way of contrast, a gap-filling power has long been recognized by the common law. In 1972, the Ontario Court of Appeal discussed the scope of authority under the Ontario *Judicature Act*[50] and its relationship to the court's general jurisdiction in the context of deciding whether the court is empowered to order an assignment expunged from the vendor's title upon the vendor furnishing adequate security in lieu of the assignment:[51]

> *As a superior Court of general jurisdiction, the Supreme Court of Ontario has all of the powers that are necessary to do justice between the parties. Except where provided specifically to the contrary, the Court's jurisdiction is unlimited and unrestricted in substantive law in civil matters.* In *Re Michie Estate and City of Toronto et al.*, [1968] 1 O.R. 266 at pp. 268-9, 66 D.L.R. (2d) 213 at pp. 215-6, Stark, J., after considering the relevant provisions of the *Judicature Act* and the authorities, said:
>
> > *It appears clear that the Supreme Court of Ontario has broad universal jurisdiction over all matters of substantive law unless the Legislature divests from this universal jurisdiction by legislation in unequivocal terms.* The rule of

> law relating to the jurisdiction of superior Courts was laid down at least as early as 1667 in the case of *Peacock v. Bell and Kendall* (1667), 1 Wms. Saund. 73 at p. 74, 85 E.R. 84:
>
> > . . . And the rule for jurisdiction is, that nothing shall be intended to be out of the jurisdiction of a Superior Court, but that which specifically appears to be so; and, on the contrary, nothing shall be intended to be within the jurisdiction of an Inferior Court but that which is so expressly alleged.
> >
> > . . . . .
> >
> > In addition, and of importance, is that the justice of the situation requires a cause such as this will not fail for want of a remedy . . .
> >
> > . . . . .
> >
> > In my view, s. 19(1) of the *Judicature Act*, R.S.O. 1970, c. 228, gives to the Court jurisdiction to make a mandatory order, even though interlocutory, directed to a party to the action if it is just and convenient to do so and in this way to require the defendants here to do such acts as may be necessary as to effectively remove the assignment in question from the title to the lands. Here the defendants seek to invoke the Court's equitable jurisdiction by asserting a claim for lien against the lands to secure the return of the moneys which they have paid. [52] [Emphasis added.]

It may be that with the increased codification in statutes, courts have lost sight of their general jurisdiction where there is a gap in the statutory language. Where there is a highly codified statute, courts may conclude that there is less room to undertake gap-filling. This is accurate insofar as the Parliament or Legislative Assembly has limited or directed the court's general jurisdiction; there is less likely to be a gap to fill. However, as the Ontario Court of Appeal observed in the above quote, the court has unlimited jurisdiction to decide what is necessary to do justice between the parties except where legislators have provided specifically to the contrary.

The court's role under the CCAA is primarily supervisory and it makes determinations during the process where the parties are unable to agree, in order to facilitate the negotiation process. Thus the role is both procedural and substantive in making rights determinations within the context of an ongoing negotiation process. [53] The court has held that because of the remedial nature of the legislation, the judiciary will exercise its jurisdiction to give effect to the public policy objectives of the statute where the express language is incomplete. [54] The nature of insolvency is highly dynamic and the complexity of firm financial distress means that legal rules, no matter how codified, have not been fashioned to meet every contingency. Unlike rights-based litigation where the court is making determinations about rights and remedies for actions that have already occurred, many insolvency proceedings involve the court making determinations in the context of a dynamic, forward moving process that is seeking an outcome to the debtor's financial distress. [55]

C. — Conclusions to be Drawn with respect to Statutory Interpretation

The exercise of a statutory authority requires the statute to be construed. The plain meaning or textualist approach has given way to a search for the object and goals of the statute and the intentionalist approach. This latter approach makes use of the purposive approach and the mischief rule, including its codification under interpretation statutes that every enactment is deemed remedial, and is to be given such fair, large and liberal construction and interpretation as best ensures the attainment of its objects. This latter approach advocates reading the statute as a whole and being mindful of Driedger's "one principle", that the words of the Act are to be read in their entire context, in their grammatical and ordinary sense harmoniously with the scheme of the Act, the object of the Act, and the intention of Parliament. It is important that courts first interpret the statute before them and exercise their authority pursuant to the statute, before reaching for other tools in the judicial toolbox. Statutory interpretation using the principles articulated above leaves room for gap-filling in the common law provinces and a consideration of purpose in *Québec* as a manifestation of the judge's overall task of statutory interpretation. Finally, the jurisprudence in relation to statutory interpretation demonstrates the fluidity inherent in the judge's task in seeking the objects of the statute and the intention of the legislature.

III. — Judicial Discretion as a Means of Filling the Gap

There can be no more chameleon concept in law than judicial discretion. Its meaning is variable and derived almost exclusively from context; but despite its myriad meanings and purposes, judicial discretion is another tool to be considered when addressing the fact pattern of under-inclusive or skeletal legislation. The *Oxford Companion to Law* gives the most common definition of discretion, building on it to define "a question of judicial discretion":

> *Discretion*. The faculty of deciding or determining in accordance with circumstances and what seems just, fair, right, equitable, and reasonable in those circumstances. Rules of law frequently vest in a judge the power or duty to exercise his [her] discretion in certain circumstances, sometimes if he [she] finds certain requisites satisfied, and sometimes a discretion within stated limits only.
>
> A question of judicial discretion is accordingly a question not determined, like a question of fact, by evidence, nor one determined, like a question of law, by authorities and argument, but one determined by an exercise of moral judgment. In cases where the discretion has long been vested in judges there is, however, a strong tendency for the ways in which judges have exercised their discretion to be reported and for subsequent judges to exercise their discretion consistently with the ways in which it has been exercised in the past, so that the discretion comes to become, not unfettered, but limited by precedents.
>
> Vesting discretionary power in judges is one of the commonest ways of individualizing the application of law and making it flexible and adaptable to circumstances; without it law would much more often be criticized as harsh, unfeeling, and unjust. [56]

If one considers the judge's task, on the way to arriving at a decision, to be the determination of the facts and the law, and then an application of the law to the facts, the exercise of discretion is not any of this, but is yet a further dimension. A question of judicial discretion is not determined by evidence, as a matter of fact might be, or by argument, as a matter of law, but rather by an exercise of "moral judgment". The judge must of course determine the facts and the law, but then after having done so, in a case that asks for the exercise of discretion, the judge applies reason and discernment, expressed in this definition as an exercise of "moral judgment". It is not our contention that parties are at the mercy of the individual moral judgments of a particular judge when discretion is exercised. Rather, the moral judgment exercised in discretionary decisions is constrained by articulation of principled grounds for its exercise in prior decisions of the courts, in appellate review decisions and, depending on the nature of the case, the equities of the parties and the dictates of fairness. In commercial relations, certainty must also play a role. [57]

Aharon Barak, Chief Justice of Israel, echoes the difficulty in defining judicial discretion:

> [Defining judicial discretion] is by no means an easy task, for the term *discretion* has more than one meaning, and indeed means different things in different contexts. Some authors have despaired of analyzing it and recommended against using the term. Yet we must reject this advice because the concept of discretion is central to an understanding of the judicial process. [58]

He continues:

> To me, discretion is the power given to a person with authority to choose between two or more alternatives, when each of the alternatives is lawful. Justice Sussman referred to this definition, saying, "Discretion means freedom to choose among different possible solutions". Hart and Sacks offered a similar definition: "Discretion means the power to choose between two or more courses of action each of which is thought of as permissible". Judicial discretion, then, means the power the law gives the judge to choose among several alternatives, each of them being lawful. . . .

. . . . .

> Discretion assumes the freedom to choose among several lawful alternatives. Therefore, discretion does not exist when there is but one lawful option. In this situation, the judge is required to select that option and has no freedom of choice. No discretion is involved in the choice between a lawful act and an unlawful act. The judge must choose the lawful act, and he [she] is precluded from choosing the unlawful act. Discretion, on the other hand, assumes the lack of an obligation to choose one particular possibility among several. Discretion assumes the existence of several options, of which the judge is entitled to choose the one that most appeals to him [her]. In the words of Justice Cardozo,
>
> > Other cases present a genuine opportunity for choice — not a choice between two decisions, one of which may be said to be almost certainly right and the other almost certainly wrong, but a choice so nicely balanced that when once it is announced, a new right and a new wrong will emerge in the announcement.
> >
> > Thus, discretion assumes a zone of possibilities rather than just one point. It is founded on the existence of a number of options that are open to the judge. . . .
> >
> > The zone of lawful options may be narrow, as when the judge is free to choose between only two lawful alternatives. Or the range of lawful options may be considerable, as when the judge stands before many lawful alternatives and combinations of alternatives. In this sense one may distinguish between narrow and broad discretion. This distinction, of course, is only relative. [59] [Footnotes omitted.]

See, too, this observation by McLachlin J., as she then was:

> Discretion may best be defined as the power to make a decision that cannot be determined to be right or wrong in any objective way. . . . Lord Diplock put it well in a recent case when he said:
>
> > The very concept of administrative discretion involves a right to choose between more than one possible course of action upon which there is room for reasonable people to hold differing opinions as to which is to be preferred.
>
> It would not be incorrect to say that discretion involves the creation of rights and privileges, as opposed to the determination of who holds those rights and privileges. [60]

This is also the sense of discretion reflected in the judgment of Richard C.J. of the New Brunswick Court of Appeal in *Doiron v. Haché*:

> *To exercise discretion means to choose between two or more reasonable options. The choice must be made considering the applicable law and guiding principles and on a proper understanding of the facts.* Where the facts are misapprehended and the error is an overriding factor in the exercise of the discretion such that the foundation for the option chosen no longer exists, then an injustice has been done. [61] [Emphasis added.]

In *Doiron*, the statement of choice was articulated in the context of dismissing an appeal on the basis of the standard of review as it relates to discretionary orders.

But we see in other contexts, the contrary analysis. Sharpe J., as he then was, writes:

> My basic argument is that it is wrong to infer from the flexibility of many doctrines applicable in commercial cases that there is a judicial discretion in the sense that the decision-making function can be accurately described as choosing from a range of equally acceptable results. I suggest that judicial choice is constrained in that the judge is duty bound to find the result that best comports with identifiable legal rules and principles. In making this argument, I do not pretend to engage in philosophical speculation on the nature of law or the extent to which it is or is not indeterminate, although I readily concede that debate has an impact on my subject. I speak rather from

> the perspective of a trial judge, attempting to articulate the legitimate expectations of litigants who come before our courts and the standards I believe our legal regime imposes upon those charged with the responsibility of deciding. In other words, I am attempting to state what I believe to be the working hypothesis of the legal regime and the standard for decision-making to which judges should aspire. [62]

As an ethical exhortation no one can take issue with this statement: Judges must strive to reach the decision that takes into account all the appropriate factors and that arrives at the most correct decision. For much of what judges do in deciding cases, there will be one decision that is more correct than the alternatives. It is also easy to think of all discretionary decisions as attracting the same appellate deference and to forget that over time many so-called discretionary decisions begin to follow a certain pattern and, thereby, are less a matter of discretion and more an application of established precedent. Consider, for example, the case of *Wong v. Lee* [63] where a discretionary rule developed by the common law was under consideration.

The issue in *Wong* was whether the rule in *Tolofson v. Jensen,* [64] which admitted an exception for exceptional cases, and therefore conferred a discretion on a trial judge to say that the law of the forum rather than the law of the accident governs, had been correctly applied. All were agreed that the Supreme Court of Canada had created a "discretion" in that a judge "may" not apply the *Tolofson* rule in exceptional cases, but as a matter of application, the majority of the Court of Appeal, without reference to the standard of appellate review regarding discretionary matters, concluded that the trial judge had erred in finding an exceptional case. Does this mean that the trial judge did not have a discretion to decide as he did?

The more probable response is that there are varying types of discretion. Some will be hedged by more factors than others, making it more likely that there is only one true result in such case, which is more akin to Sharpe J.'s theory as in the above quote. But this does not mean that the judge did not have a discretion. It may mean that the choices were narrowed considerably. *Wong* is illustrative of the principle that not all discretionary decisions are of the same nature either in their exercise at first instance or as a matter of appellate review.

If we return to insolvency context and its legislative framework, the s. 11 stay provisions of the CCAA are illustrative. Section 11(1) specifies:

> 11.
> Powers of court — (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.

This section has been interpreted as conferring an authority to do many things, and in empowering the court to make orders as it sees fit, s. 11(1) also confers a discretion on the court. The nature of that discretion will depend on the order being sought. The first significant question is, however, does the judge have the authority to do what is asked?

Consider the matter of when a court is asked to order debtor in possession (DIP) financing under the s. 11 CCAA stay provisions. The courts have found authority for granting super-priority financing under both the CCAA and under the proposal provisions of the BIA, even though there is no express authority. [65] Having once found the authority to order DIP financing, a judge then has to decide whether to exercise that power or not as a matter of discretion. The court balances interests, considers relative prejudice and assesses the reasonableness of a particular process, decision or remedy. In finding that the court has jurisdiction to authorize DIP financing under the CCAA, the British Columbia Court of Appeal held that the effective achievement of the legislation's objectives requires a broad and flexible exercise of jurisdiction to facilitate a restructuring, and the court's equitable jurisdiction permits orders granting super-priority in some circumstances. [66]

The distinction between authority and discretion is of some meaning to the chambers judge, because he or she needs to know what to do. For an appellate judge, the distinction is crucial because the standard of review with respect to a finding of authority and an exercise of discretion is completely different. The first one will attract a standard of correctness and the second one will be considered with the deferential standard accorded to discretionary decisions in mind.

Discretion, in addition to recognizing authority, is a label that invokes a standard of review, or in the words of the Hon. Roger P. Kerans is "a label for non-intervention on functional grounds". [67] Appeal court judges speak in terms of discretionary orders and it can also be a code for not seeing a basis for intervention or that the nature of the case should preclude intervention. [68]

The Canadian standard of appellate review of truly discretionary decisions is based on a definition of discretion theory, which postulates more than one equally valid choice. The standard of appellate review is stated thus:

> The function of an appellate court . . . is not to exercise an independent discretion of its own. It must defer to the judge's exercise of his [her] discretion and must not interfere with it merely on the ground that members of the appellate court would have exercised the discretion differently. The function of the appellate court is initially one of review only. It may set aside the judge's exercise of his [her] discretion on the ground that it was based on a misunderstanding of the law or of the evidence before him [her] or on an inference that particular facts existed or did not exist, which, although it was one that might legitimately have been drawn on the evidence that was before the judge, can be demonstrated to be wrong by further evidence that has become available by the time of the appeal, or on the ground that there has been a change of circumstances after the judge made his [her] order. [69]

In light of articulated reasons, the appellate court reviewing a judge's exercise of discretion may find it appropriate to assess the conclusion on this deferential standard.

An example is the Ontario Court of Appeal judgment in *Naneff v. Con-Crete Holdings Ltd.* [70] The case involved the appeal of the remedy granted in an oppression remedy case under the Ontario *Business Corporations Act.* [71] Blair J., when he was on the Superior Court, awarded an oppression remedy to a director/shareholder who had been ousted from the family business because of his lifestyle. He ordered a public sale of the business, allowing both the son and the father that founded the business the opportunity to bid on the company. The Ontario Court of Appeal affirmed the oppressive conduct, but set aside the remedy on the basis that the discretion to grant a remedy, while broad, can only be exercised to rectify the actual oppressive conduct. [72] The Court held:

> The provisions of s. 248(3) give the court a very broad discretion in the manner in which it can fashion a remedy. *Broad as that discretion is, however, it can only be exercised for a very specific purpose; that is, to rectify the oppression.* This qualification is found in the wording of s. 248(2) which gives the court the power, if it finds oppression or certain other unfair conduct, to "make an order to rectify the matters complained of". Therefore, the result of the exercise of the discretion contained in s. 248(3) must be the rectification of the oppressive conduct. If it has some other result the remedy would be one which is not authorized by law.
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> . . . . .
>
> . . . Persons who are shareholders, officers and directors of companies may have other personal interests which are intimately connected to a transaction. However, it is only their interests as shareholder, officer or director as such which are protected by s. 248 of the O.B.C.A. The provisions of that section cannot be used to protect or to advance directly or indirectly their other personal interests.
>
> *I conclude, therefore, that the discretionary powers in s. 248(3) O.B.C.A. must be exercised within two important limitations*:

(i) *they must only rectify oppressive conduct*

(ii) *they may protect only the person's interest as a shareholder, director or officer as such.*

The law is clear that when determining whether there has been oppression of a minority shareholder, the court must determine what the reasonable expectations of that person were according to the arrangements which existed between the principals. The cases on this issue are collected and analyzed by Farley J. in *820099 Ontario Inc. v. Harold E. Ballard Ltd.* (1991), 3 B.L.R. (2d) 113 at p. 123 (Ont. Gen. Div.); affirmed (1991), 3 B.L.R. (2d) 113 (Ont. Div. Ct.). I agree with his comment at pp. 185-86:

> Shareholder interests would appear to be intertwined with shareholder expectations. It does not appear to me that the shareholder expectations which are to be considered are those that a shareholder has as his own individual "wish list". They must be expectations which could be said to have been (or ought to have been considered as) part of the compact of the shareholders.

The determination of reasonable expectations will also, in my view, have an important bearing upon the decision as to what is a just remedy in a particular case.

. . . . .

It is my view that the first error in principle in this remedy is that it did more than simply rectify oppression. As I noted above, the O.B.C.A. authorizes a court to rectify oppressive conduct. I think the words of Farley J. in *Ballard*, *supra*, at p. 197 are very appropriate in this respect:

> The court should not interfere with the affairs of a corporation lightly. *I think that where relief is justified to correct an oppressive type of situation, the surgery should be done with a scalpel, and not a battle axe. I would think that this principle would hold true even if the past conduct of the oppressor were found to be scandalous. The job for the court is to even up the balance, not tip it in favour of the hurt party.* I note that in *Explo* [*Explo Syndicate v. Explo Inc.*, a decision of the Ontario High Court, released June 29, 1989], Gravely L.J.S.C. stated at p. 20:

In approaching a remedy the court, in my view, should interfere as little as possible and *only to the extent necessary to redress the unfairness.*

[Italics in original, emphasis added.]

The Court of Appeal held that the remedy imposed constituted an error in principle in that it did more than rectify oppression, and it did more than protect the son's interest as a shareholder as such in the companies as it sought to protect his interest as a family member. [73] The Court ordered the remedy set aside and substituted a remedy whereby the appellant family members acquired all of the shares that the son owned in any of the companies making up the family business at fair market value, without minority discount. [74]

From an appellate perspective, the treatment of the standard of review for discretionary decision-making will vary depending on a variety of factors, including at what stage of the process discretion is being exercised. This is why it is important in extracting a principle from a decision regarding judicial discretion to ask whether the authority or power in question is being exercised:

1. by a trial judge in rendering a final decision;

2. by a chambers judge as a final order;

3. by a chambers judge as an interlocutory order;

4. by an appellate judge sitting in chambers granting leave to appeal or staying a judgment falling into one of the above categories; or

5. by an appellate court deciding whether to intervene in one of the above contexts.

It is also important to assess the kinds of decisions courts classify as discretionary. It stands to reason that decisions that by their nature permit eventual review of the exercise of authority at a later date or that maintain the *status quo* or involve the management of the trial and the pre-trial process are more easily obtainable and less likely to be overturned on appeal. There will be some discretionary decisions for which there are either equally balanced decisions or decisions that will have less significance to the litigation or the litigants, all of which more easily attract the deferential standard. Examples of decisions in the commercial area most likely to be sustained on appeal are: interim appointment of receivers, monitors and other insolvency professionals as officers of the court; Anton Piller orders; and orders that have a come-back clause. Specialized courts or judges must also be factored into the equation. By way of contrast, examples of decisions that are more closely reviewed are: the interpretation of legislation or agreements; application of a priority structure; enforcement of security; determinations that affect parties not before the courts; and decisions that take away rights without a trial or without an examination on *viva voce* evidence. In such cases, a court of appeal will be more likely to intervene for a variety of reasons, including to avoid the spectre of inconsistent results.

One must not overlook the "law-making" powers of appellate courts. Appellate courts will hesitate to interfere with the lower court's exercise of discretion in the interests of timeliness and finality, but there are cases that demonstrate when appellate courts have found it necessary to provide guidance on the manner in which discretion is being exercised in order to reduce uncertainty for parties. [75] In this sense, the statutory framework envisions that appeals will be limited, and the exercise of judicial discretion determines those limited circumstances in which it is important to review the lower court judgment. [76] This approach is evident in Canadian insolvency case law, in terms of the standards for granting leave to appeal judgments, usually only where there are "serious and arguable grounds that are of real and significant interest to the parties". [77] The Ontario Court of Appeal in *Stelco* held that the appellate courts, in the context of a CCAA proceeding, will only grant leave to appeal where such serious and arguable grounds are determined in accordance with a four-pronged test, namely, whether the point on appeal is of significance to the practice; whether the point is of significance to the action; whether the appeal is *prima facie* meritorious or frivolous; and whether the appeal will unduly hinder the progress of the restructuring process. [78]

In *Re Algoma Steel*, the Ontario Court of Appeal made the following observation in respect of cases in which the statutory language requires leave to appeal and where there is a come-back clause set out in the lower court order. The Court commented that due to the often urgent, complex and dynamic nature of CCAA proceedings, appellate courts should be cautious about intervening in the CCAA process: [79]

> 2 Farley J.'s order was an initial order made pursuant to s. 11(3) of the CCAA, on a motion by Algoma. It was made without notice to the Noteholders. The essence of Farley J.'s order was an authorization to Algoma to obtain additional financing ("the DIP Financing") from its existing bank lenders during the 30 day stay period permitted by s. 11(3) of the CCAA. *The purpose of the order was to respond, on an urgent and interim basis, to a serious negative cash flow crisis at Algoma. Indeed, without short-term financial assistance designed to serve as a base for restructuring Algoma's current indebtedness, Algoma might well have had to cease operations.* The order also gave priorities (which the parties call superpriorities) to the DIP Financing charge and to certain Administration and Directors Charges over the Noteholders' existing security.
>
> . . . . .
>
> 7 In our view, the motion for leave to appeal is premature. Initial orders, made on a without notice basis, are specifically authorized by s. 11(1) of the CCAA. *Proceedings under the CCAA are often urgent, complex and dynamic.*

> The Algoma proceedings fit that description. Farley J. was faced with complex facts and a difficult decision potentially implicating the closure of one of the largest companies in Ontario. Moreover, he had to make his decision in a very timely fashion. In these circumstances, he recognized that his initial order might not be acceptable to all interested parties, including some of Algoma's creditors. That is why he included a comeback clause in his order and specifically invited parties to resort to it in his endorsement.
>
> 8 The fact that the CCAA provides that an appeal of an initial order is only available with leave indicates that appeals in CCAA proceedings should be limited. *An Appeal Court should be cautious about intervening in the CCAA process, especially at an early stage.* [Emphasis added.]

A consideration of purpose guides trial courts in determining how a statutory discretion should be exercised and is a basis on which an appellate court will assess a trial court's exercise of discretion. [80] Professor Sullivan cites *Canadian Pacific Ltd. v. Matsqui Indian Band* where Lamer C.J. states that in considering whether the trial judge exercised his discretion reasonably, it is important not to lose sight of Parliament's objective and the underlying purpose and functions of the particular tax assessment scheme under consideration. [81] In the area of commercial law, the Court of Appeal in *Stelco* picks up this idea of "purpose" by referring first to the statutory framework of the CCAA, in which the court is authorized by the stay provisions to extend protection to the company during the workout process:

> [32] The CCAA is remedial legislation and is to be given a liberal interpretation to facilitate its objectives: *Babcock & Wilcox Canada Ltd. (Re)*, [2000] O.J. No. 786, 5 B.L.R. (3d) 75, ¶11 (S.C.J.). See also, *Chef Ready Foods Ltd. v. Hong Kong Bank of Canada*, [1990] B.C.J. No. 2384, 4 C.B.R. (3d) 311 (C.A.), at p. 320 C.B.R.; *Re Lehndorff General Partners Ltd.*, [1993] O.J. No. 14, 17 C.B.R. (3d) 24 (Gen. Div.). Courts have adopted this approach in the past to rely on inherent jurisdiction, or alternatively on the broad jurisdiction under s. 11 of the CCAA, as the source of judicial power in a CCAA proceeding to "fill in the gaps" or to "put flesh on the bones" of that Act: see *Re Dylex Ltd.*, [1995] O.J. No. 595, 31 C.B.R. (3d) 106 (Gen. Div. (Commercial List)), *Royal Oak Mines Inc. (Re)*, [1999] O.J. No. 864, 7 C.B.R. (4th) 293 (Gen. Div. (Commercial List)); and *Westar Mining Ltd. (Re)*, [1992] B.C.J. No. 1360, 70 B.C.L.R. (2d) 6 (S.C.).
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> . . . . .
>
> [36] In the CCAA context, Parliament has provided 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. *The s. 11 discretion is the engine that drives this broad and flexible statutory scheme, and that for the most part supplants the need to resort to inherent jurisdiction.* [82] [Emphasis added.]

The Court concludes that the CCAA stay provision is intended to extend protection to a company while it attempts to negotiate a 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. The s. 11 discretion is thus broad and flexible under the statutory scheme. [83]

The Court of Appeal went on to hold that the court's discretion under s. 11 of the CCAA is not open-ended and unfettered; rather, it is guided by the objectives and scheme of the *Act* and by the legal principles that govern corporate law issues. What the court does under s. 11 is establish the boundaries of the playing field and act as a referee in the process. [84] In the course of acting as referee, the court has authority to 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. [85]

Professor Waddams similarly acknowledges that the word discretion, when used with reference to judicial decision-making, "is neither a simple nor a single concept". [86] He observes:

> . . . "Discretion" is sometimes used to indicate that a legal rule has elements of uncertainty; sometimes it refers to a need for restrictions upon rights of appeal in the interests of expedition and finality; sometimes the word refers to a situation where the nature of the decision is such that the initial decision-maker is as likely as a reviewing court to reach a satisfactory conclusion; and sometimes it refers to situations where the initial decision-maker is thought to have a positive advantage in this respect. These concepts are different from each other, and have differing implications for the proper role of appellate tribunals. In many cases more than one concept is in play at the same time, with, it will be suggested, consequent confusion of ideas.
>
> All legal rules, as has always been recognized, contain elements of uncertainty because the circumstances in which the rules come to be applied cannot be precisely foreseen, nor can any rule, however detailed, describe in advance every possible future case. Many important and fundamental legal rules are necessarily very general, and are "open-textured" in nature, or allow for openended exceptions. It is sometimes said of rules of this kind that they are "discretionary". [87]

In the accompanying footnote, Professor Waddams observes "this [referring to open-textured rules or rules that allow for open-ended exceptions] is the meaning generally intended in discussions of judicial discretion" [88] citing Professor Dworkin's text *Taking Rights Seriously*. [89]

The reference to Professor Dworkin takes us to the timeless debate between Professors Hart and Dworkin regarding what has become known as the debate about "Hard Cases", taking its name from an article written by the latter. [90] In *Taking Rights Seriously*, Professor Dworkin takes up this issue:

> Legal positivism provides a theory of hard cases. When a particular lawsuit cannot be brought under a clear rule of law, laid down by some institution in advance, then the judge has, according to that theory, a "discretion" to decide the case either way. His opinion is written in language that seems to assume that one or the other party had a pre-existing right to win the suit, but that idea is only a fiction. In reality he has legislated new legal rights, and then applied them retrospectively to the case at hand. In the last two chapters I argued that this theory of adjudication is wholly inadequate; in this chapter I shall describe and defend a better theory.
>
> I shall argue that even when no settled rule disposes of the case, one party may nevertheless have a right to win. It remains the judge's duty, even in hard cases, to discover what the rights of the parties are, not to invent new rights retrospectively. I should say at once, however, that it is no part of this theory that any mechanical procedure exists for demonstrating what the rights of parties are in hard cases. On the contrary, the argument supposes that reasonable lawyers and judges will often disagree about legal rights, just as citizens and statesmen disagree about political rights. This chapter describes the questions that judges and lawyers must put to themselves, but it does not guarantee that they will all give these questions the same answer. [91]

Professor Hart responds to Professor Dworkin in a postscript to the second edition of his book on *The Concept of Law*:

> The sharpest direct conflict between the legal theory of this book and Dworkin's theory arises from my contention that in any legal system there will always be certain legally unregulated cases in which on some point no decision either way is dictated by the law and the law is accordingly partly indeterminate or incomplete. If in such cases the judge is to reach a decision and is not, as Bentham once advocated, to disclaim jurisdiction or to refer the points not regulated by the existing law to the legislature to decide, he must exercise his discretion and make law for the case instead of merely applying already pre-existing settled law. So in such legally unprovided-for or unregulated cases the judge both makes new law and applies the established law which both confers and constrains his law-making powers.

> This picture of the law as in part indeterminate or incomplete and of the judge as filling the gaps by exercising a limited law-creating discretion is rejected by Dworkin as a misleading account both of the law and of judicial reasoning. He claims in effect that what is incomplete is not the law but the positivist's picture of it, and that this is so will emerge from his own "interpretive" account of the law as including besides the explicit settled law identified by reference to its social sources, implicit legal principles which are those principles which both best fit or cohere with the explicit law and also provide the best moral justification for it. On this interpretive view, the law is never incomplete or indeterminate, so the judge never has occasion to step outside the law and exercise a law-creating power in order to reach a decision. It is therefore to such implicit principles, with their moral dimensions, that courts should turn in those "hard cases" where the social sources of the law fail to determine a decision on some point of law.
>
> It is important that the law-creating powers which I ascribe to the judges to regulate cases left partly unregulated by the law are different from those of a legislature: not only are the judge's powers subject to many constraints narrowing his choice from which a legislature may be quite free, but since the judge's powers are exercise only to dispose of particular instant cases he cannot use these to introduce large-scale reforms or new codes. So his powers are interstitial as well as subject to many substantive constraints. Nonetheless there will be points where the existing law fails to dictate any decision as the correct one, and to decide cases where this is so the judge must exercise his law-making powers. But he must not do this arbitrarily: that is he must always have some general reasons justifying his decision and he must act as a conscientious legislator would by deciding according to his own beliefs and values. But if he satisfies these conditions he is entitled to follow standards or reasons for decision which are not dictated by the law and may differ from those followed by other judges faced with similar hard cases. [92]

Judges will fall on one side or the other of the debate depending on how they view the judge's role in general, and how they view it in particular cases. One's views on this topic will also affect and be affected by the extent to which one believes a judge's decisions should be insulated from appellate review. If a judge believes that intervention should be limited, the Hartian expression of discretion will be embraced. For others, who believe that intervention is permissible generally, or in a particular case, Professor Dworkin's analysis will be more palatable. No one view prevails, and as it has already been indicated, much depends on the nature of the issue being decided.

Precision in word definition and use is as important here as it is with relying on "inherent jurisdiction", discussed in Part IV below. It is easy to mistake power or authority with discretion and become confused by the use of the word "may" in a statute. [93] Kerans and Willey write:

> **(a) — Confusion of Discretion with Power**
>
> The "discretion" usage arose about 300 years ago. At that time English judges used it to describe judicial power. Thus, for example, an appeal court with the power to order a new trial would, in 1655, refer to that power as a discretion. To a degree, the practice continues today. A judge may say, for example, "I have the discretion to award or deny costs." In this sense, discretion simply means "choice". Or, a court might use the word "discretion" to describe any new statutory power (e.g., a court "may"). In this context, the term "may" contributes more to confusion than it does to certainty. Indeed, judges do not *always* use the word "discretion" to describe a statutory power. We have never heard the power to convict or acquit, for example, described as a discretion! Furthermore, some of the powers commonly called discretionary, including many where the statute now says "the judge in his discretion may," were already categorized as such by the courts long before codification by rule or statute.
>
> The usage does not adequately serve as a guide for a standard of review. Of course, first judges have choices about how to decide cases. But any choice may be reviewed, and reversed, by an appeal court. In that event, the only choice is to be right or wrong. On the other hand, if the appeal court decides not to review the first judge's decision, it must be for some reason other than the mere fact that the first judge had a choice. It would be absurd to say: "I will not intervene because the first judge had a choice." It is equally absurd to say, "I will not intervene because

> the first judge had a discretion." Something more is required. That something is the reason why an appeal court should not intervene.
>
> Justice Barak uses the term to mean "the power given to a person with authority to choose between two or more alternatives, when each of the alternatives is lawful". That supposes that the source of authority, like a constitution or a statute, is cast in such a way that it permits judges at least two ways to decide a case. It is a way to state the law-making rule of judges. It is not very helpful in the context of appellate review, because the function of review is to decide whether to approve the choice made. It does suffice, however, to emphasize the respect for *ad hoc jurisprudence* built into much of the law of appeals.
>
> [Footnotes omitted]

Thus, it can be said that we tend to label too quickly decisions as discretionary. Another common mistake is to speak as though "discretion" and "discretionary decision" have the same juridical consequences.

If we return to our objective of looking for the appropriate tool to address the problem of under-inclusive or skeletal legislation, judicial discretion, in one or more of its forms, is an important tool, but one must understand in what sense one is using it. Is it being used to indicate an authority or a power? Is it being used in the open-textured way as mentioned by Professor Waddams [94] and Newbury J.A. in *Skeena*? [95] Is it being referred to as a means of identifying those decisions that are sheltered from appellate review either for reasons of an expeditious process or because the judge of first instance is considered to be better able to make the decision? Or are we using judicial discretion as yet another means of filling the gap between principle and policy as contemplated in the debate between Professors Dworkin and Hart?

Whether it is the highly codified BIA or the skeletal CCAA, the court has used its authority to make both procedural and substantive decisions that assist the parties in meeting the overall objectives of the legislation. The court will use tests such as fairness, reasonableness, and a weighing of the equities and/or a balancing of prejudice to make determinations regarding when to exercise its discretion. [96]

The exercise of the court's discretion under insolvency and bankruptcy statutes depends on the nature of the judicial function under the particular proceeding; the statutory framework and specific requirements that are implicated in a particular dispute; and a consideration of what is just and reasonable in the circumstances, including a balancing of the interests of, and prejudice to, the stakeholders with an interest in the financially distressed firm. [97]

The courts have observed the need for flexibility at the same time as being cognizant that they are to ensure a timely process and provide certainty to parties with an interest in the proceeding. The courts have held that "'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 makes its exercise an exercise in equity — and 'reasonableness' is what lends objectivity to the process". [98] The court will weigh the equities that flow from granting or refusing relief in particular circumstances. [99]

Thus, the courts have developed a number of principles articulating the factors they weigh and apply even in the broadest grant of statutory discretion. These principles have developed over time, with the court's aim of providing the parties with consistency and certainty, while upholding the objectives of the legislation. As Professor Waddams has observed, flexibility in the exercise of judicial discretion is desirable; yet at the same time, the court must develop the law on a rational and consistent basis, applying broad principles to particular issues before them. [100] Arguably, that is what the courts have undertaken in insolvency and bankruptcy matters.

The courts have also recognized the public interests underlying insolvency legislation, finding that "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 broader constituency of affected

persons". [101] Consideration of the public interest is one aspect of the court's assessment of the viability and fairness of the proposed plan within the existing statutory scheme of priorities. [102] The court, in exercising its discretion, has held that there is a broader public dimension that must be considered and weighed in the balance, as well as the interests of those most directly affected. [103]

The principles underlying statutory discretion are applied in both the common law and civil law jurisdictions in Canada. For example, the Québec Superior Court in *MEI Computer Technology Group Inc.* held that the CCAA is a remedial statute that is to be given a liberal interpretation to facilitate its objectives, and that in facilitating the achievement of the CCAA's objectives, courts have relied on their inherent jurisdiction or alternatively, on their broad discretion under s. 11 of the CCAA, as the source of judicial power to "fill the gaps" or "put flesh on the bones" of the statute. [104] While the scope for exercise of that discretion may differ in some circumstances, in part because of the degree of codification of Québec's *Civil Code*, the exercise of both statutory discretion and inherent jurisdiction discretion is common to all Canadian jurisdictions.

Hence we turn next to inherent jurisdiction. It is only where broad statutory authority is unavailable that inherent jurisdiction needs to be considered as a possible judicial tool to utilize in the circumstances. In the ordering of judicial tools, it should necessarily come last as a potential source of authority, given that courts are to seek direction on their authority first from the statutes.

IV. — Inherent Jurisdiction as a Gap-Filling Tool

A starting point for a discussion of inherent jurisdiction as a gap-filling tool is I.H. Jacob's article "The Inherent Jurisdiction of the Court", [105] written in 1970 and recognized by the Supreme Court of Canada as the foundational work in the area. [106] I.H. Jacob articulated the importance of a court's inherent jurisdiction:

> . . . The jurisdiction which is inherent in a superior court of law is that which enables it to fulfill itself as a court of law. The juridical basis of this jurisdiction is therefore the authority to uphold, to protect and to fulfill the judicial function of administering justice according to law in a regular, orderly and effective manner. [107]

He summarizes its nature in contradistinction to the general jurisdiction of the court, of which it forms a part:

> To understand the nature of the inherent jurisdiction of the court, it is necessary to distinguish it first from the general jurisdiction of the court, and next from its statutory jurisdiction.
>
> The term "inherent jurisdiction of the court" does not mean the same thing as "the jurisdiction of the court" used without qualification or description: the two terms are not interchangeable, for the "inherent" jurisdiction of the court is only a part or an aspect of its general jurisdiction. The general jurisdiction of the High Court as a superior court of record is, broadly speaking, unrestricted and unlimited in all matters of substantive law, both civil and criminal, except in so far as that has been taken away in unequivocal terms by statutory enactment. The High Court is not subject to supervisory control by any other court except by due process of appeal, and it exercises the full plenitude of judicial power in all matters concerning the general administration of justice within its area. Its general jurisdiction thus includes the exercise of an inherent jurisdiction.
>
> Moreover, the term "inherent jurisdiction of the court" is not used in contradistinction to the jurisdiction conferred on the court by statute. The contrast is not between the common law jurisdiction of the court on the one hand and its statutory jurisdiction on the other, for *the court may exercise its inherent jurisdiction even in respect of matters which are regulated by statute or by rule of court, so long as it can do so without contravening any statutory provision.* There is, nevertheless, an important difference between the nature of the inherent jurisdiction of the court and its statutory jurisdiction. The source of the statutory jurisdiction of the court is of course the statute itself, which will define the limits within which such jurisdiction is to be exercised, whereas *the source of the inherent jurisdiction of*

> *the court is derived from its nature as a court of law, so that the limits of such jurisdiction are not easy to define, and indeed appear to elude definition.*
>
> Perhaps the true nature of the inherent jurisdiction of the court is not a simple one but is to be found in a complex of a number of features, some of which may be summarized as follows:
>
> (1) The inherent jurisdiction of the court is exercisable as part of the process of the administration of justice. *It is part of procedural law, both civil and criminal, and not of substantive law; it is invoked in relation to the process of litigation.*
>
> (2) The distinctive and basic feature of the inherent jurisdiction of the court is that it is exercisable by summary process, *i.e.*, without a plenary trial conducted in the normal or ordinary way, and generally without waiting for the trial or for the outcome of any pending or other proceeding.
>
> (3) *Because it is part of the machinery of justice, the inherent jurisdiction of the court may be invoked not only in relation to the litigant parties in pending proceedings, but in relation also to anyone, whether a party or not, and in respect of matters which are not raised as issues in the litigation between the parties.*
>
> (4) *The inherent jurisdiction of the court is a concept which must be distinguished from the exercise of judicial discretion. These two concepts resemble each other, particularly in their operation, and they often appear to overlap, and are therefore sometimes confused the one with the other. There is nevertheless a vital juridical distinction between jurisdiction and discretion, which must always be observed.*
>
> (5) The inherent jurisdiction of the court may be exercised in any given case, notwithstanding that there are Rules of Court governing the circumstances of such case. The powers conferred by Rules of Court are, generally speaking, additional to, and not in substitution of, powers arising out of the inherent jurisdiction of the court. The two heads of powers are generally cumulative, and not mutually exclusive, so that in any given case, the court is able to proceed under either or both heads of jurisdiction. [108] [Emphasis added.]

Finally, he summarizes his views in this conclusion:

> It will be seen therefore that the inherent jurisdiction of the court exists as a separate and independent basis of jurisdiction, apart from statute or Rules of Court. *It has developed and now exists not only as a separate independent doctrine from the jurisdiction in contempt, but also from any provision dealing with practice and procedure made by statute or Rules of Court.* It stands upon its own foundation, and the basis for its exercise is put on a different and perhaps even wider footing from the jurisdiction in contempt, namely, to prevent oppression or injustice in the process of litigation and to enable the court to control and regulate its own proceedings. Parliament has now recognized the existence of inherent jurisdiction of the court as a separate doctrine, but has not attempted to define its nature or its limits.
>
> *In this light, the inherent jurisdiction of the court may be defined as being the reserve or fund of powers, a residual source of powers, which the court may draw upon as necessary whenever it is just or equitable to do so, and in particular to ensure the observance of the due process of law, to prevent improper vexation or oppression, to do justice between the parties and to secure a fair trial between them.* A definition somewhat to this effect may be found in the Indian *Code of Civil Procedure*, which provides
>
> > Nothing in this code shall be deemed to limit or otherwise affect the inherent power of the court to make such orders as may be necessary for the ends of justice or to prevent abuse of the process of the court.
>
> It may be objected that this view of the nature of the inherent jurisdiction of the court postulates the existence of an amplitude of amorphous powers, which may be arbitrary in operation and which are without limit in extent. The answer is that a jurisdiction of this kind and character is a necessary part of the armoury of the courts to enable them to administer justice according to law. *The inherent jurisdiction of the court is a virile and viable doctrine which in the*

> *very nature of things is bound to be claimed by the superior courts of law as an indispensable adjunct to all their other powers, and free from the restraints of their jurisdiction in contempt and the Rules of Court, it operates as a valuable weapon in the hands of the court to prevent any clogging or obstruction of the stream of justice.* [109] [Emphasis added.]

While much of this reasoning is significant for our purposes, and is itself a summary, we wish to underscore the following points. First, the source of the inherent jurisdiction of a superior court is derived from its nature as a court of law. Second, a court may exercise its inherent jurisdiction even in respect of matters that are regulated by statute or by rule of court, so long as it can do so without contravening any statutory provision. Third, inherent jurisdiction may be invoked by anyone, whether a party or not, and in respect of matters that are not raised as issues in the litigation between the parties. Fourth, there is a vital juridical distinction between jurisdiction and discretion, which must always be observed. Finally, inherent jurisdiction of the court may be defined as "being the reserve or fund of powers, a residual source of powers, which the court may draw upon as necessary whenever it is just or equitable to do so, and in particular to ensure the observance of the due process of law, to prevent improper vexation or oppression, to do justice between the parties and to secure a fair trial between them". [110]

Master Jacob also states that the inherent jurisdiction of the court "is part of procedural law . . . and not of substantive law; it is invoked in relation to the process of litigation". [111] This point has been the subject of recent debate, including at the level of the Supreme Court of Canada, as we will now discuss.

In areas apart from commercial law, the Supreme Court of Canada has embraced the concept of inherent jurisdiction to grant leave to appeal to a non-party; [112] to determine which of two operationally conflicting decisions of an administrative tribunal should take precedence where compliance with one necessitates violation of the other; [113] to grant a required remedy that an arbitrator is not empowered to grant; [114] and as the means to modify or extend the common law in order to comply with prevailing social conditions and values. [115] In this last case, *Hill v. Church of Scientology of Toronto*, the Supreme Court held:

> 83 In emphasizing that the common law should develop in a manner consistent with *Charter* principles, a distinction was drawn between private litigants founding a cause of action on the *Charter* and judges exercising their inherent jurisdiction to develop the common law.
>
> . . . . .
>
> 91 It is clear from *Dolphin Delivery*, *supra*, that the common law must be interpreted in a manner which is consistent with Charter principles. This obligation is simply a manifestation of the inherent jurisdiction of the courts to modify or extend the common law in order to comply with prevailing social conditions and values. As was said in *Salituro*, supra, [[1991] 3 S.C.R. 654] at p. 678:
>
> > The courts are the custodians of the common law, and it is their duty to see that the common law reflects the emerging needs and values of our society.
>
> 92 Historically, the common law evolved as a result of the courts making those incremental changes which were necessary in order to make the law comply with current societal values. The *Charter* represents a restatement of the fundamental values which guide and shape our democratic society and our legal system. It follows that it is appropriate for the courts to make such incremental revisions to the common law as may be necessary to have it comply with the values enunciated in the *Charter*.

More recently, in *Western Canadian Shopping Centres Inc. et al v. Dutton et al* we see this statement:

> 34. *Absent comprehensive legislation, the courts must fill the void under their inherent power to settle the rules of practice and procedure as to disputes brought before them*: *Bell v. Wood*, [1927] 1 W.W.R. 580 at pp. 581-82 (B.C.S.C.);

> *Langley v. North West Water Authority*, [1991] 3 All E.R. 610 (C.A.); leave denied [1991] 1 W.L.R. 711n (H.L.); *Newfoundland Association of Public Employees v. Newfoundland* (1995), 132 Nfld. & P.E.I.R. 205; W.A. Stevenson and J.E. Côté, *Civil Procedure Guide*, 1996, at p. 4. However desirable comprehensive legislation on class action practice may be, if such legislation has not been enacted, the courts must determine the availability of the class action and the mechanics of class action practice.
>
> . . . . .
>
> 44. Where the conditions for a class action are met, the court should exercise its discretion to disallow it for negative reasons in a liberal and flexible manner, like the courts of equity of old. The court should take into account the benefits the class action offers in the circumstances of the case as well as any unfairness that class proceedings may cause. In the end, the court must strike a balance between efficiency and fairness.
>
> . . . . .
>
> 48 To summarize, class actions should be allowed to proceed under Alberta's Rule 42 where the following conditions are met: (1) the class is capable of clear definition; (2) there are issues of fact or law common to all class members; (3) success for one class member means success for all; and (4) the proposed representative adequately represents the interests of the class. If these conditions are met the court must also be satisfied, in the exercise of its discretion, that there are no countervailing considerations that outweigh the benefits of allowing the class action to proceed. [116]

Arguably many of these uses of inherent jurisdiction find their thrust in "procedural law . . . and not . . . substantive" law to use the words of Master Jacob above quoted, but several involve findings of substantive law or, perhaps, an expression of the court's willingness to use its inherent jurisdiction to modify or extend the common law in order to fill gaps in legislation or otherwise do justice to the parties and to comply with prevailing social conditions and values.

In commercial matters, there has been, at least until recently, a particular willingness at least by trial courts to use inherent jurisdiction to fill gaps in legislation, particularly in restructuring matters. The early history of this exercise of jurisdiction has been gathered elsewhere. [117] Of this early history, we note *Re Westar Mining Ltd.*; [118] MacDonald J. of the British Columbia Supreme Court used inherent jurisdiction to find authority to grant a secured charge to suppliers that continued to supply during a CCAA proceeding to ensure that the company could carry on business pending development of a plan:

> 17. The issue is whether or not those suppliers who are prepared (or have been compelled, between May 14 and June 10) to extend the credit which will hopefully keep the Company operating during the period of the stay, should be secured. I have concluded that "justice dictates" they should, and that the circumstances call for the exercise of this court's inherent jurisdiction to achieve that end. (See, *Winnipeg Supply & Fuel v. Genevieve Mortgage Corp.*, [1972] 1 W.W.R. 651 at p. 657 (Man. C.A.).
>
> 18. *The circumstances in which this court will exercise its inherent jurisdiction are not the subject of an exhaustive list.* The power is defined by Halsbury's (4th ed., volume 23, para. 14) as:
>
> > . . . the reserve or fund of powers, a residual source of powers, which the Court may draw upon as necessary whenever it is just or equitable to do so . . .
>
> 19. *Proceedings under the CCAA are a prime example of the kind of situations where the court must draw upon such powers to "flesh out" the bare bones of an inadequate and incomplete statutory provision in order to give effect to its objects.*
>
> The analogy to the powers and priority which may be granted by the court to a receiver-manager is not necessary to support the exercise of this court's inherent jurisdiction to create the charge in question here. (See, *Lochson Holdings. v. Eaton Mechanical* (1984), 55 B.C.L.R. 54 at pp. 57/8 (B.C.C.A.)). Indeed, different considerations apply. In the

> receiver-manager cases it is the property which is being safeguarded by the court. *Under the CCAA it is the survival of the company which owns the property, for long enough to present a plan of reorganization, that is the court's concern.* In my view, the three exceptions to the "general rule" discussed in *Lochson Holdings* do not exhaust the circumstances, under the CCAA, in which the court may "authorize expenses for the carrying on of the business".
>
> . . . . .
>
> 23. *This court "has inherent powers in respect to any matter within its jurisdiction . . . and may draw [thereon] to give effect to the provisions of [a] statute".* [119]
>
> . . . . .
>
> 25. Whether a reorganization plan for the Company can be successful remains to be seen. In the meantime, this court should do whatever can be done to provide such an opportunity. The importance of the Company's operations to the south-east corner of the province in particular, and to the economy of the province as a whole, justifies that approach. [Emphasis added.]

This reasoning was subsequently endorsed by Farley J. of the Ontario Court of Justice (General Division) in *Re Dylex Ltd.*:

> In the interim between the filing and the approval of a plan, the court has the inherent jurisdiction to fill in gaps in legislation so as to give effect to the objects of CCAA, including the survival program of a debtor until it can present a plan: see *Re Westar Mining Ltd.* (1992), 14 C.B.R. (3d) 88 at pp. 93-4 (B.C.S.C.). [120]

Consistent with this earlier authority, we note the decision of Topolniski J. in *Residential Warranty Co. of Canada Inc., Re* in 2006. [121] In *Re Residential Warranty*, the applicant insurance company sought an order declaring that the trustee in bankruptcy was not entitled to use the realization of any property for the purpose of paying its fees in respect of the proceedings relating to a disputed trust claim. The Alberta Court of Queen's Bench held that the BIA expressly preserves the court's equitable and ancillary powers and that accordingly, inherent jurisdiction is maintained and available as an important but sparingly used tool. [122] The Court held that there are two preconditions to the court exercising its inherent jurisdiction: the BIA must be silent on the point or not have dealt with it exhaustively; and after balancing the competing interests, the benefit of granting the relief must outweigh the relative prejudice to those affected by it. [123] The Court held that: "inherent jurisdiction is available to ensure fairness in the bankruptcy process and fulfillment of the substantive objectives of the BIA, including the proper administration and protection of the bankrupt's estate". [124]

The Court held that while the BIA is detailed legislation, Parliament did not take away any inherent jurisdiction from the court, but in fact provided that the court may direct an interim receiver "to take such other action as the court considers advisable" to do not only what justice dictates, but practicality demands. [125] The trustee's responsibility is to ensure that only valid claims to the assets under administration are recognized. [126] The Court held that the trustee was a necessary party to the appeal, in order to participate as an officer of the court and present the relevant facts in a non-adversarial manner; and that "to rule otherwise would be to open the door for possible abuse of the system by rogue claimants filing spurious proprietary claims". [127] The Court contrasted exercise of inherent jurisdiction under the BIA and the CCAA: [128]

> [78] Except in the context of commercial restructuring cases under the BIA, caution must be exercised when considering developments concerning inherent jurisdiction emanating from the CCAA. The BIA and CCAA are very different in degree of specificity and the policy considerations involved. For example, courts in CCAA proceedings routinely rationalize financing for commercial restructuring that compromises creditors' traditional interests in the name of the greater good. There is an overarching policy concern favouring the possibility of a going

> concern solution and the potential of a long-term upside value for a broad constituency of stakeholders. Arguably, in some cases, super-priority financing and priming charges must be available if restructuring is to be a possibility. [Footnotes omitted.]

Here, the policy consideration was not to facilitate a potential business survival, but rather, to maintain the integrity of the bankruptcy system and to be fair, while recognizing established trust law. [129] On the facts, it was appropriate to fashion a charge that respected the limitations previously imposed by the courts in terms of the trustee's work for the general estate administration. [130]

The Alberta Court of Appeal, in affirming this judgment, held that the judge had inherent jurisdiction pursuant to the BIA to permit the trustee's fees to be paid from property that was subject to undetermined trust claims in appropriate circumstances, and that she did not err in the exercise of jurisdiction in the circumstances. [131] The Court of Appeal held that the ultimate purpose of the administrative powers granted a trustee under the BIA was to manage the estate in order to provide equitable satisfaction of the creditors' claims. As a result of the assistance that the trustee provided to the court and all of the claimants in the bankruptcies, it was just and practical that inherent jurisdiction be used to grant the charge for its fees.

The Court of Appeal noted that section 183(1) of the BIA preserves the inherent jurisdiction of the superior court; it specifies that the courts are invested with such jurisdiction at law and in equity as will enable them to exercise original, auxiliary and ancillary jurisdiction in bankruptcy and in other proceedings authorized by the BIA. The Court of Appeal held that inherent jurisdiction is not without limits, and that it cannot be used to negate the unambiguous expression of legislative will. Moreover, because it is a special and extraordinary power, it should be exercised only sparingly and in a clear case. [132] The Court observed that further limitations are based on the nature of the BIA, which is a detailed and specific statute providing a comprehensive scheme aimed at ensuring the certainty of equitable distribution of a bankrupt's assets among creditors. In this context, there should not be frequent resort to the power. [133] The Court of Appeal held that inherent jurisdiction has been used where it is necessary to promote the objects of the BIA; [134] where there is no other alternative available; and to accomplish what justice and practicality require. [135]

The Court of Appeal held that generally, inherent jurisdiction should only be exercised where it is necessary to further fairness and efficiency in legal process and to prevent abuse. The Court listed the non-exhaustive factors that should be considered before invoking inherent jurisdiction:

> [37] Generally, inherent jurisdiction should only be exercised where it is necessary to further fairness and efficiency in legal process and to prevent abuse. The following non-exhaustive factors should be considered before invoking inherent jurisdiction here:
>
> 1. The strength of the trust claim being asserted. The mere assertion of a trust claim is not determinative of the validity of the trust and cannot preclude the trustee from investigating concerns. In some cases, the trust claim may be obvious, as was the case in *C.J. Wilkinson*, where the claim was based on statutory trusts in favour of employees or tax authorities and the interim receiver conceded their validity. In other circumstances, a trustee will have no choice but to have the issue of the trust determined in order to further the administration of the bankruptcy. In that event, the ultimate beneficiary of the trust may have to shoulder the costs of the determination;
>
> 2. The stage of the proceedings and the effect of such an order on them. For example, the ability of the trustee to make distributions and their amount may depend on the determination of the issue;
>
> 3. The need to maintain the integrity of the bankruptcy process. The equitable distribution of the bankrupt estate must remain at the fore-front. The court should recognize the expertise of the trustee in this regard and in effective management of bankruptcy: see *GMAC* at para. 50 [*GMAC Commercial Credit Corp. v. T.C.T.*

> *Logistics Inc.*, [2006] 2 S.C.R. 123]. Also, the court should assess the extent to which the determination is necessary to administer the bankruptcy and discourage academic or potentially unrewarding litigation;
>
> 4. The realistic alternatives in the circumstances. This could include a s. 38 order, deferring a decision or empowering a court to review the decision in the future, for example, after final determination of the claims and the extent of the property available for distribution. The court should consider whether there is an existing guarantee of the trustee's fees, whether the party ultimately determined to be the beneficiary might bear some responsibility for the costs, and whether counsel might be hired on contingency;
>
> 5. The impact on the trust claimants and on the trust property as well as on other creditors. The court should examine the breadth of the trust claims, the existence of competing proprietary claims, and whether the trust claims leave any assets in the estate for unsecured creditors in assessing which stakeholder is going to suffer most from the trustee's disputing of the trust claim. In that exercise, the court should assess what part of the estate would ideally bear the burden of costs. It is important to consider whether the determination would proceed by default if the trustee were not fully funded;
>
> 6. The anticipated time and costs involved. The court should contemplate whether the proposed determination represents an efficient and effective means of resolving the issue to the benefit of all stakeholders. Consideration should be given to expediting the process;
>
> 7. The limits that can be placed on the fees or charge; and
>
> 8. The role that the trustee will take in the determination process.

The Court of Appeal dismissed the appeal, finding that the case management judge recognized the power must be used sparingly, considered the relevant factors and the applicable law, and carefully constructed a limited charge suitable in the circumstances. [136]

The Alberta court appears to be viewing inherent jurisdiction expansively; however, in the above-cited case, the parties did not make submissions in respect of whether statutory authority may have been sufficient to find jurisdiction. The case may also illustrate the court's reluctance to gap-fill where a statute is highly codified and hence the judge may have wanted to ensure that all the grounds of authority were relied on. Under our analysis, gap-filling can still occur under statutory authority and the common law where there is truly a gap in statutory language, even for a more codified statute. The other issue to note is that courts, in the exigencies of real time litigation, may not be able easily to discern the basis of their authority. While this paper is a call for more clarity and precision in the grounds relied on, we appreciate the challenge that such precision may pose in the circumstances of a particular case.

The Ontario courts are returning to the more traditional base with extensive reference to I.H. Jacob's theories, which may very well be where British Columbia has been throughout. In *Re United Used Auto & Truck Parts Ltd.*, Mackenzie J.A., writing for the British Columbia Court of Appeal, discussed the court's authority to order costs of administration on a primed basis, based not on inherent jurisdiction, preferring instead to refer to the "equitable jurisdiction of the Court":

> 15 The function of the monitor is set out in some detail but the only reference to the cost of carrying out the monitor's function is the oblique reference in s. 11.8(2) that costs of statutory claims on the debtor arising before the monitor's appointment will not rank as a cost of administration. I do not think that it can be inferred that the monitor's costs of administration were otherwise overlooked by Parliament or that Parliament intended that the court have no authority to provide for those costs. The only reasonable conclusion in my opinion is that Parliament was aware of the court's general jurisdiction in equity and assumed that jurisdiction remained available except as inconsistent with the Act. Indeed, by requiring the appointment of a monitor Parliament made a jurisdiction to provide for the monitor's costs of administration even more necessary.
>
> . . . . .

18 Neither *Canadian Asbestos* (1992), 16 C.B.R. (3d) 114 nor *Starcom* (1998), 3 C.P.R. (4th) 177 specifically referred to the source of the jurisdiction. Macdonald J. in *Re Westar Mining Ltd.* (1992), 14 C.B.R.(3d) 88, relied on in *Starcom*, referred to the jurisdiction simply as inherent jurisdiction (at 93). Macdonald J. noted that Dickson J., speaking for the Supreme Court of Canada in *Baxter Student Housing Ltd. v. College Housing Co-operative Ltd.*, [1976] 2 S.C.R. 475, held that inherent jurisdiction with respect to receiver-managers could not be exercised in conflict with a statute. The origins of the receivers' jurisdiction are located in the equitable jurisdiction of the Court of Chancery and *while that jurisdiction cannot be exercised contrary to a statute nothing precludes its exercise to supplement a statute and effect a statutory object.*

. . . . .

30 *In my opinion, an equitable jurisdiction is available to support the monitor which is sufficiently flexible to be adapted to the monitor's role under the CCAA. It is a time honoured function of equity to adapt to new exigencies.* At the same time it should not be overlooked that costs of administration and DIP financing can erode the security of creditors and CCAA orders should only be made if there is a reasonable prospect of a successful restructuring. That determination is largely a matter of judgment for the judge at first instance and appellate courts normally will be slow to interfere with an exercise of discretion.

31 *In my opinion, super-priority for DIP financing rests on the same jurisdictional foundation in equity.* Priority for the reasonable restructuring fees and disbursements could have been allowed as part of DIP financing. It is immaterial that they have been allowed here as part of the administration charge. [137]

[Emphasis added.]

This reasoning was expanded in another judgment of the British Columbia Court of Appeal in *Skeena* in which Newbury J.A., writing for the Court, marked a preference for statutory interpretation and judicial discretion conferred by the statute rather than inherent jurisdiction:

37 In the exercise of their "broad discretion" under the CCAA, it has now become common for courts to sanction the indefinite, or even permanent, affecting of contractual rights. Most notably, in *Re Dylex Ltd.* (1995), 31 C.B.R. (3d) 106 (Ont. Ct. (Gen. Div.)), Farley J. followed several other cases in holding that in "filling in the gaps" of the CCAA, a court may sanction a plan of arrangement that includes the termination of leases to which the debtor is a party. (See also the cases cited in Dylex, at para. 8; *Re T. Eaton Co.* (1999), 14 C.B.R. (4th) 288 at 293-4 (Ont. S.C.); *Smoky River Coal*; *supra* [[1991] 11 W.W.R. 734], and *Re Armbro Enterprises Inc.* (1993), 22 C.B.R. (3d) 80, ¶13 (Ont. Ct. (Gen. Div.)).) In the latter case, R.A. Blair J. said he saw nothing in principle that precluded a court from "interfering with the rights of a landlord under a lease, in the CCAA context, any more than from interfering with the rights of a secured creditor under a security document. Both may be sanctioned when the exigencies of the particular re-organization justify such balancing of the prejudices". In its recent judgment in *Syndicat national de l'amiante d'Asbestos inc. v. Jeffrey Mines Ltd*, [2003] Q.J. No. 264, the Quebec Court of Appeal observed that "A review of the jurisprudence shows that the debtor's right to cancel contracts prejudicial to it can be provided for in an order to stay proceedings under s. 11." (para. 74.)

. . . . .

40 Of course, there are also statutory and constitutional limitations on the court's exercise of its authority under the CCAA. The Supreme Court of Canada's decision in *Baxter Student Housing Ltd. v. College Housing Cooperative Ltd.*, [1976] 2 S.C.R. 475 confirmed that it is beyond the authority of a CCAA court to provide for a priority that runs contrary to the express terms of a statute (in that case, the *Mechanics Lien Act* of Manitoba.) Thus in *Baxter*, the fact that the provincial legislation created a lien having priority over "all judgments, executions, assignments,

attachments, garnishments and receiving orders", precluded an order granting CMHC priority for new advances over and above all prior registered liens. Dickson J. (as he then was) stated for the Court:

> . . . the inherent jurisdiction of the Court of Queen's Bench is not such as to empower a judge of that Court to make an order negating the unambiguous expression of the legislative will. The effect of the order made in this case was to alter the statutory priorities *which a Court simply cannot do*. [at 480; emphasis added.]

41 *Baxter* continues to be applied today: see *Re Royal Oak Mines Inc.* (1999), 7 C.B.R. (4th) 293 (Ont. Ct. (Gen. Div.)) and *Re Westar Mining Ltd.* (1992), 70 B.C.L.R. (2d) 6 (B.C.S.C.). However, the Court in *United Used Auto* distinguished *Baxter* on the basis that the former did not involve an express statutory priority that could not be overcome by the Court's equitable jurisdiction. Mackenzie J.A. noted that the receiver's jurisdiction originates in the "equitable jurisdiction of the Court of Chancery and [that] while that jurisdiction cannot be exercised contrary to a statute, nothing precludes its exercise to supplement a statute and effect a statutory object". (para. 18.)

42 It may be unnecessary to add that in cases of direct or express conflict between the CCAA itself and a provincial statute, the doctrine of paramountcy would apply and the federal statute would prevail.

. . . . .

45 It is true that in "filling in the gaps" or "putting flesh on the bones" of the CCAA — for example, by approving arrangements which contemplate the termination of binding contracts or leases — courts have often purported to rely on their "inherent jurisdiction". Farley J. did so in *Dylex*, for example, at para. 8, and in *Royal Oak*, *supra*, at para. 4, the latter in connection with the granting of a "superpriority"; and Macdonald J. did so in *Westar*, supra, at 8 and 13. *The court's use of the term "inherent jurisdiction" is certainly understandable in connection with a statute that confers broad jurisdiction with few specific limitations. But if one examines the strict meaning of "inherent jurisdiction", it appears that in many of the cases discussed above, the courts have been exercising a discretion given by the CCAA rather than their inherent jurisdiction. . . .*

. . . . .

46 . . . I think the preferable view is *that when a court approves a plan of arrangement under the CCAA which contemplates that one or more binding contracts will be terminated by the debtor corporation, the court is not exercising a power that arises from its nature as a superior court of law, but is exercising the discretion given to it by the CCAA.* (As to the meaning of "discretion" in this context, see S. Waddams, "Judicial Discretion", (2001) 1 Cmnwth. L.J. 59.) *This is the discretion, given by s. 11, to stay proceedings against the debtor corporation and the discretion, given by s. 6, to approve a plan which appears to be reasonable and fair, to be in accord with the requirements and objects of the statute, and to make possible the continuation of the corporation as a viable entity.* It is these considerations the courts have been concerned with in the cases discussed above, rather than the integrity of their own process.

47 In saying this, I leave to one side the jurisdiction of the court to make special provision for the payment of the fees and expenses of a monitor appointed under the CCAA. The monitor's functions are of course analogous to those of a receiver — traditionally a creature of Equity. I suspect that this particular power may be properly described as both an equitable jurisdiction and a statutory discretion. *As this court said in United Used Auto, nothing precludes the exercise of the equitable jurisdiction of the Court of Chancery to "supplement a statute and effect a statutory object".* (para. 18.) In any event, the distinction between these two sources of authority is one that, in my mind at least, "eludes definition".

[Emphasis added.] [138]

Writing in similar vein, in *Stelco*, Blair J.A. overturned a chambers decision in which the supervising judge in a CCAA proceeding made an order removing directors from the board of an insolvent company. [139] The Court of Appeal held

that an order to remove directors could not be founded on inherent jurisdiction, as inherent jurisdiction is a power derived from the nature of the superior court, which permits the court to maintain its authority; control its own process and fulfill the judicial function of administering justice according to law in a regular, orderly and effective manner. However, inherent jurisdiction is not limitless and if the statutes have not left a functional gap or vacuum, then inherent jurisdiction should not be brought into play: [140]

> [33] It is not necessary, for purposes of this appeal, to determine whether inherent jurisdiction is excluded for all supervisory purposes under the CCAA, by reason of the existence of the statutory discretionary regime provided in that Act. In my opinion, however, *the better view is that in carrying out his or her supervisory functions under the legislation, the judge is not exercising inherent jurisdiction but rather the statutory discretion provided by s. 11 of the CCAA and supplemented by other statutory powers that may be imported into the exercise of the s. 11 discretion from other statutes through s. 20 of the CCAA.*
>
> **Inherent jurisdiction**
>
> [34] *Inherent jurisdiction is a power derived "from the very nature of the court as a superior court of law", permitting the court "to maintain its authority and to prevent its process being obstructed and abused". It embodies the authority of the judiciary to control its own process and the lawyers and other officials connected with the court and its process, in order "to uphold, to protect and to fulfill the judicial function of administering justice according to law in a regular, orderly and effective manner"* . . .
>
> [35] *In spite of the expansive nature of this power, inherent jurisdiction does not operate where Parliament or the legislature has acted. As Farley J. noted in Royal Oak Mines, supra, inherent jurisdiction is "not limitless";* if the legislative body has not left a functional gap or vacuum, then inherent jurisdiction should not be brought into play" (para. 4). See also, *Baxter Student Housing Ltd. v. College Housing Co-operative Ltd.*, [1976] 2 S.C.R. 475, 57 D.L.R. (3d) 1, at p. 480 S.C.R.; *Richtree Inc. (Re)* (2005), 74 O.R. (3d) 174, [2005] O.J. No. 251 (S.C.J.).
>
> [36] In the CCAA context, Parliament has provided 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. The s. 11 discretion is the engine that drives this broad and flexible statutory scheme, and that for the most part supplants the need to resort to inherent jurisdiction. In that regard, I agree with the comment of Newbury J.A. in *Clear Creek Contracting Ltd. v. Skeena Cellulose Inc.*, [2003] B.C.J. No. 1335, 43 C.B.R. (4th) 187 (C.A.), at para. 46, that:
>
> > . . . the court is not exercising a power that arises from its nature as a superior court of law, but is exercising the discretion given to it by the CCAA. . . . This is the discretion, given by s. 11, to stay proceedings against the debtor corporation and the discretion, given by s. 6, to approve a plan which appears to be reasonable and fair, to be in accord with the requirements and objects of the statute, and to make possible the continuation of the corporation as a viable entity. It is these considerations the courts have been concerned with in the cases discussed above, rather than the integrity of their own process. [footnote omitted]
>
> . . . . .
>
> [38] I do not mean to suggest that inherent jurisdiction can never apply in a CCAA context. The court retains the ability to control its own process, should the need arise. There is a distinction, however — difficult as it may be to draw — between the court's process with respect to the restructuring, on the one hand, and the course of action involving the negotiations and corporate actions accompanying them, which are the company's process, on the other hand. The court simply supervises the latter process through its ability to stay, restrain or prohibit proceedings against the company during the plan negotiation period "on such terms as it may impose". Hence the better view is that a judge is generally exercising the court's statutory discretion under s. 11 of the Act when supervising a CCAA

> proceeding. The order in this case could not be founded on inherent jurisdiction because it is designed to supervise the company's process, not the court's process. [Emphasis added.]

The Court of Appeal further held that while s. 11 does not provide the authority for a CCAA judge to order the removal of directors, section 20 of the CCAA offers a gateway to the oppression remedy and other provisions of the *Canada Business Corporations Act* (CBCA) and similar provincial and territorial corporations statutes. [141] Hence, the Court held that there is no "legislative gap" to fill, and that where another applicable statute confers jurisdiction with respect to a matter, a broad and undefined discretion provided in one statute cannot be used to supplant or override the other applicable statute. [142] The powers of a judge under s. 11 of the CCAA may be applied together with the provisions of the CBCA, including the oppression remedy provisions of that statute.

The Ontario Court of Appeal took the same view of the court's powers under s. 11 of the CCAA in *Re Ivaco Inc.* [143] While the Court in that case upheld the chamber judge's decision to move the head office of two companies from Québec to Ontario, it did so taking pains to say that the court's authority did not rest in s. 11, but in s. 191(2) of the *Canada Business Corporations Act*. It expressly distinguished *Stelco* on the basis that in the latter case there was no power elsewhere to accomplish the chamber judge's goals. Laskin J.A., speaking for the Court in *Ivaco*, wrote: "[t]he discretion under s. 11 must be used to control the court's processes, not the company's processes".

In *Mine Jeffrey inc., Re*, the Québec Court of Appeal endorsed the flexible approach of other Canadian courts in respect of jurisdiction under the CCAA in a case where the monitor had become the person designated by the court to act in the stead of the debtor's directors during the arrangement negotiation period: [144]

> 30 Contrary to a winding-up under the *Winding-up and Restructuring Act* (R.S.C. (1985), c. W-11) (hereinafter referred to as the "*Winding-up Act*") or to an assignment under the BIA, the aim of the CCAA is not the termination of the debtor's operations and the distribution of its assets to creditors; rather, as indicated in its very title, the aim is to conclude arrangements between the insolvent company and its creditors so as to enable the company to survive, the whole under the supervision of the court. Chief Justice Duff wrote in *Attorney General of Canada, supra*, at 661:
>
> > Furthermore, the aim of the Act is to deal with the existing condition of insolvency, in itself, to enable arrangements to be made, in view of the insolvent condition of the company under judicial authority which, otherwise, might not be valid prior to the initiation of proceedings in bankruptcy.
>
> 31 To achieve that aim, the CCAA allows the court to make all orders necessary to maintain the *status quo* during the period required for a proposal to be made to the creditors. The Court of Appeal of British Columbia wrote in *United Used Auto and Truck Parts Ltd. v. Aziz*, [2000] BCCA 146:
>
> > The legislation is intended to have wide scope and allow a judge to make orders which will effectively maintain the status quo for a period while the insolvent company attempts to gain the approval of its creditors for a proposed arrangement which will enable the company to remain in operation for what is, hopefully, the future benefit of both the company and its creditors.
>
> 32 In *PCI Chemicals Canada Inc.* (Plan d'arrangement de transaction ou d'arrangement relatif à), [2002] R.J.Q. 1093 (S.C.), *Danièle Mayrand J. did a remarkable job of summarizing the jurisprudence, making the following comments, with which I agree*:
>
> **[Translation]**
>
> > [52] The vitality of the CCAA is due in part to the way it has been interpreted by the courts, primarily in Ontario, British Columbia and Alberta. *These courts opted for a broad and liberal interpretation of the CCAA and the notion of "inherent jurisdiction" and "equity" in order to give effect to the aims of the CCAA, which are to enable companies to remain in operation so that they can find a solution to their insolvency and turn their financial*

situation around. The courts concluded that the CCAA must be interpreted and applied in this way in order to provide a flexible tool for restructuring insolvent companies.

[53] On the basis of these concepts, the courts have not hesitated in recent years to render orders-such as the debtor's right to cancel contracts-that have become almost routine under the CCAA.

[54] A number of these judgments draw on the Supreme Court decision in *Baxter Student Housing Ltd. v. College Housing Co-operative Limited*, for the purpose of exercising their inherent jurisdiction and giving effect to the objectives of the CCAA. The Supreme Court stated that a court's inherent jurisdiction does not allow it to render an order negating the unambiguous expression of the legislative will. In *Re Westar Mining Ltd.*, Macdonald J. referred to *Baxter* and established the principle that would be followed in several judgments:

> *Proceedings under the CCAA are a prime example of the kind of situation where the Court must draw such powers to "flesh out" the bare bones of an inadequate incomplete statutory provision in order to give effect to its objectives11.*

[58] Certain decisions rendered by the Court of Appeal on other CCAA related matters show that the Court of Appeal shares the same vision as the other Canadian courts regarding the need for a broad, liberal interpretation in order to give effect to the objectives of the CCAA.

. . . . .

[74] A review of the jurisprudence shows that the debtor's right to cancel contracts prejudicial to it can be provided for in an order to stay proceedings made under section 11.

. . . . .

35 Section 11.7(3)(d) CCAA, cited above, recognizes that the court can also entrust other functions to the monitor. Examples include control over property, which was awarded in this case under the initial order. Similarly, the court can authorize the monitor to carry on the business of the debtor's company, as explicitly recognized under section 11.8 CCAA ("where a monitor carries on in that position the business of a debtor company"). That was allowed under paragraph 7 of the impugned order. Thus, in the case at bar, the debtor's affairs are administered by a monitor further to orders rendered by the court. That was, of course, made necessary by the resignation of the debtor's directors and the need to resume operations in order to follow through on the Thiokol project and generate a substantial profit while preserving business relations with a very important client of the debtor, which is crucial to any effort to revitalize the company.

. . . . .

44 There is nothing in the orders rendered about the abolishment or modification of the [union] certifications. Thus, the appellants' certifications are still valid and in effect. Furthermore, it is doubtful that the Superior Court would have jurisdiction to rule on such matters, as determined by the majority in conjunction with the winding-up of the Coopérants (*Syndicat des employés de coopératives d'assurance-vie v. Raymond, Chabot, Fafard, Gagnon inc.*, [1997] R.J.Q. 776 (C.A.)), unless that were allowed under a constitutionally valid provision in the CCAA. It follows that the appellants' exclusive representation continues, which, incidentally, is recognized in paragraph 6 of the initial order, where it is stated that a notice to their union constitutes a notice to their employees.

. . . . .

53 I would add that I find it difficult to apply the monitor's power to disclaim a contract, with or without the authorization of the court, to a collective agreement because of the attendant legislative framework, whether federal or provincial as the case may be, which makes such an agreement a truly original instrument rather than a mere bilateral contract. Besides, why cancel collective agreements if the certifications remain in effect and, as a result, the

> employer is obliged to negotiate with the appropriate union the conditions applicable to a new delivery of services by employees contemplated by the said certifications? Negotiating a new agreement is equivalent to agreeing on amendments to an existing agreement. [Emphasis added, footnotes omitted.]

Not surprisingly, given the civilist's approach to under-inclusive legislation, [145] the court relies primarily on the purpose and aims of the legislation.

The Supreme Court of Canada decision in *GMAC Commercial Credit Corporation — Canada v. T.C.T. Logistics Inc.* offers an analysis of inherent jurisdiction in the context of insolvency legislation interacting with other remedial legislation. In *GMAC Commercial Credit Corporation — Canada v. T.C.T. Logistics Inc.*, the Supreme Court of Canada considered the extent to which the collective bargaining rights of employees as creditors in a bankruptcy must yield to the overall objective in a bankruptcy of maximizing the ability of creditors to minimize their losses; and in particular, whether employees should be entitled to the same access to a remedy as other stakeholders who attempt to challenge a trustee's conduct. [146] Abella J. writing for the Court held that the powers granted to the bankruptcy court under s. 47(2) of the BIA to direct an interim receiver's conduct do not explicitly or implicitly confer authority on the bankruptcy court to make unilateral declarations about the rights of third parties affected by other statutory schemes. [147] The effect of s. 72(1), which specifies that unless there is a conflict with the BIA, any legislation relating to property and civil rights is deemed to be supplemental to, and not abrogated by, the BIA, is that the BIA is not intended to extinguish legally protected labour relations rights that are not in conflict with the BIA. [148] Hence the bankruptcy court does not have jurisdiction to decide whether an interim receiver is a successor employer within the meaning of labour relations legislation.

The Supreme Court held that trustees and receivers are entitled to a measure of deference consistent with their expertise in the effective management of a bankruptcy; however, the Court held that guarding the flexibility given to such officers with boilerplate immunizations that inoculate against the assertion of rights is beyond the therapeutic reach of the BIA. [149] The right to seek a successor employer declaration pursuant to provincial labour relations legislation does not conflict with the bankruptcy court's authority under s. 47(2). The Court held that if the s. 47 net were interpreted widely enough to permit interference with all rights that, though protected by law, represent an inconvenience to the bankruptcy process, it could be used to extinguish all rights; and explicit language would be required before such a sweeping power could be attached to s. 47. [150] This ruling was consistent with the reasoning of Slatter J. of the Alberta Court of Queen's Bench in *Re Big Sky Living Inc.* [151]

Hence, the courts are trying to articulate the contours of their use of inherent jurisdiction in insolvency matters. The Court of Appeal judgments in *Skeena* and *Stelco* serve to alert courts to the necessity of specifying the grounds for their judicial decision making, and provided some direction on the breadth and scope of the statutory discretion under the CCAA, building on the earlier judgment of the British Columbia Court of Appeal in *Re United Used Auto & Truck Parts*. The Supreme Court of Canada, rounding out consideration of the interaction of different statutory schemes in *GMAC Commercial Credit Corporation — Canada v. T.C.T. Logistics Inc.*, makes clear that there are limits to the court's exercise of jurisdiction, and that the courts are to be diligent to ensure that any exercise of that jurisdiction does not affect the rights of parties under other statutory schemes, unless they are in conflict with federal insolvency legislation.

V. — Conclusion

The court's jurisdiction in insolvency matters has long been the subject of debate, focused particularly on the question of the scope and limits of the court's exercise of its inherent jurisdiction. Recent judgments of Canadian appellate courts have sought to clarify the use of both statutory discretion under insolvency legislation and use of inherent jurisdiction as a gap-filling technique in the determination of issues. Both the British Columbia Court of Appeal and the Ontario Court of Appeal have expressed a preference for the court relying on the exercise of its statutory authority and discretion in insolvency matters, rather than a broad expansion of the use of inherent jurisdiction. [152] The exercise of the court's

authority or discretion depends on the nature of the judicial function under the particular proceeding; the statutory framework and specific requirements that are implicated in a particular dispute; and a consideration of what is just and reasonable in the circumstances, including a balancing of the interests of, and prejudice to, the stakeholders with an interest in the financially distressed firm. [153]

On the authors' reading of the commercial jurisprudence, the problem most often for the court to resolve is that the legislation in question is under-inclusive. It is not ambiguous. It simply does not address the application that is before the court, or in some cases, grants the court the authority to make any order it thinks fit. [154] While there can be no magic formula to address this recurring situation, and indeed no one answer, it appears to the authors that practitioners have available a number of tools to accomplish the same end. In determining the right tool, it may be best to consider the judicial task as if in a hierarchy of judicial tools that may be deployed. The first is examination of the statute, commencing with consideration of the precise wording, the legislative history, the object and purposes of the Act, perhaps a consideration of Driedger's principle of reading the words of the Act in their entire context, in their grammatical and ordinary sense harmoniously with the scheme of the Act, the object of the Act, and the intention of Parliament, and a consideration of the gap-filling power, where applicable. It may very well be that this exercise will reveal that a broad interpretation of the legislation confers the authority on the court to grant the application before it. Only after exhausting this statutory interpretive function should the court consider whether it is appropriate to assert an inherent jurisdiction. Hence, inherent jurisdiction continues to be a valuable tool, but not one that is necessary to utilize in most circumstances.

Courts must clearly articulate the basis for their authority in order to create transparency, certainty and predictability for parties, having regard to commercial realities and public policy notions of the public interest in a fair and timely resolution of commercial disputes. A driving principle of commercial law is that courts should do what makes sense commercially in the context of what is the fairest and most equitable in the circumstances. Courts need to be as specific as possible on the source of the authority. If the statute confers discretion on the court, the basis for the choices made should be clearly articulated so as to ensure appropriate appellate treatment. This means judges must tighten the language they utilize in exercising their authority. When courts are making a determination pursuant to a statute, they are exercising their power or authority, not their discretion. As noted in the introduction, there is a difference between the court exercising its power or authority under a statute and the exercise of its discretion under a statute, although the difference is not always apparent. There may be an element of discretion, particularly when the courts are choosing from a range of remedies, but for the most part, their judgment is based on their authority to resolve the dispute and should be articulated as such. This clarity in language will assist with the transparency and certainty of their decisions, a benefit for the parties before them and of assistance to the appellate court in engaging in any review.

Appellate courts are more likely to accord deference to the appropriate exercise of discretion granted under a statute. It is important to draw a clear distinction between the court's exercise of power pursuant to the statute or its equitable jurisdiction to fill gaps in insolvency legislation and the exercise of inherent jurisdiction. Where inherent jurisdiction is invoked, appellate courts are more likely to scrutinize the basis of the lower court's authority and whether it advances the principles that have been articulated for the use of inherent jurisdiction as a gap-filling technique. In respect of statutory authority, it is also important to distinguish when a choice is being made from a range of remedies authorized by the statute, based on what is the most fair and reasonable in the circumstances and the exercise of a discretion where there may be two equally compelling remedies or outcomes, based on the statutory language and the facts as found.

As noted at the outset, this discussion of selecting the appropriate judicial tool is ongoing and our understanding of the use of tools such as gap-filling powers under legislation, inherent jurisdiction, and judicial discretion is evolving. Much more can be written on many of the points raised in this paper. A conscious effort over the next period to define more clearly the source of authority will continue the process of enhancing the insolvency law regime, having regard to fairness, equity, the public interest and commercial reasonableness.

Footnotes

1 Madam Justice Georgina R. Jackson, Court of Appeal for Saskatchewan; Dr. Janis P. Sarra, University of British Columbia Faculty of Law and Director, National Centre for Business Law. An earlier version of this paper was presented in discussion format at the National Judicial Institute's annual Civil Law Seminar. The authors would like to thank NJI for that opportunity. Justice Jackson would like to acknowledge the research assistance of Ms. Kristy Pozniak, Student-at-law, Court of Appeal for Saskatchewan with respect to that earlier draft. Dr. Sarra would like to thank Bettina Ruhstein, UBC law student for her research assistance. This paper, in part, reflects the further development of Professor Sarra's earlier analysis of the use of judicial authority and discretion, discussed in *Rescue! The Companies' Creditors Arrangement Act* (Toronto, Carswell, 2007). Our sincere thank you also to the reviewers, who provided extremely insightful comments on the draft of the paper.

2 *Bank of Nova Scotia v. Omni Construction Co.* (1981), 14 Sask. R. 81 (Sask. C.A.).

3 *Companies' Creditors Arrangement Act*, R.S.C. 1985, c. C-36 as amended.

4 *Canadian Airlines Corp., Re* (2000), [2000] A.J. No. 771, 2000 CarswellAlta 662 (Alta. Q.B.); leave to appeal refused (2000), 2000 CarswellAlta 919 (Alta. C.A. [In Chambers]); affirmed (2000), 2000 CarswellAlta 1556 (Alta. C.A.); leave to appeal refused (2001), 2001 CarswellAlta 888 (S.C.C.).

5 *Algoma Steel Inc. v. Union Gas Ltd.* (2003), 63 O.R. (3d) 78 (Ont. C.A.).

6 *Stelco Inc., Re* (2005), [2005] O.J. No. 1171, 75 O.R. (3d) 5, 2005 CarswellOnt 1188 (Ont. C.A.).

7 D.J. Galligan, *Discretionary Powers: A Legal Study of Official Discretion* (Oxford: Clarendon Press, 1990) at 40. Footnotes omitted but see in particular P.S. Atiyah, *From Principles to Pragmatism: Changes in the Function of the Judicial Process and the Law* (Oxford: Clarendon Press, 1978).

8 *Ibid.* at 40.

9 *Bankruptcy and Insolvency Act*, R.S.C. 1985, c. B-3, as amended (BIA).

10 *Re Skeena Cellulose Inc.* (2003), [2003] B.C.J. No. 1335, 43 C.B.R. (4th) 187 (B.C. C.A.).

11 *Stelco*, *supra*, note 6.

12 *GMAC Commercial Credit Corp. — Canada v. TCT Logistics Inc.* (2006), [2006], 2 S.C.R. 123, 2006 CarswellOnt 4621 (S.C.C.).

13 Ruth Sullivan, *Sullivan and Driedger on the Construction of Statutes*, 4th ed. (Markham: Butterworths, 2002).

14 Pierre-André Côté, *The Interpretation of Legislation in Canada*, 3rd. ed. (Toronto: Carswell, 2000).

15 Elmer A. Driedger, *The Construction of Statutes* (Toronto: Butterworths, 1974), at 67.

16 Sullivan, *supra*, note 13 at 1 to 18; Ruth Sullivan "Statutory Interpretation in the Supreme Court of Canada" (1998-1999) 30 Ottawa L.Rev. 175.

17 Côté, *supra*, note 14 at 287 to 294.

18 Stephane Beaulac and Pierre-Andre Côté, "Driedger's Modern Principle at the Supreme Court of Canada: Interpretation, Justification, Legitimization" (2006) 40 R.J.T. 131. Available at SSRN: http://ssrn.com/abstract=987199. In brief capsule, Beaulac and Côté point out that Canadian courts have not been consistent in the application of the principle. Much more could be said about this article, which merits close reading. See, too, Randal N. Graham *Statutory Interpretation* (Toronto: Emond Montgomery Publications Limited, 2001) at 110, 111.

19 *Re Rizzo & Rizzo Shoes Ltd.*, [1998] 1 S.C.R. 27 (S.C.C.).

20 Ontario *Employment Standards Act*, R.S.O. 1980, c. 137, as amended.

21 *Re Rizzo & Rizzo Shoes Ltd.*, *supra*, note 19, at para. 21.

22 *Ibid.*, at para. 27.

23 Ontario *Interpretation Act*, R.S.O. 1990, c. I.11.

24 Coté, *supra*, note 14 at 375 to 405. See, for example, s.12 of the federal *Interpretation Act*, R.S.C., 1985, c. I-21:

> 12.
> Every enactment shall be deemed remedial, and shall be given such fair, large and liberal construction and interpretation as best ensures the attainment of its objects.

25 *Ibid.*, at 399.

26 *Ibid.*

27 *Ibid.*

28 *Ibid.*, at 403.

29 Sullivan, *supra*, note 13 at 195.

30 *Ibid.*, at 228.

31 *Bell Canada v. Canada (Canadian Radio-Television & Telecommunications Commission)*, [1989] 1 S.C.R. 1722 (S.C.C.).

32 *Ibid.*, at 1762.

33 Coté, *supra*, note 14 at 380.

34 *Ibid.*, at *386*.

35 *Ibid.*, at 387.

36 *Ibid.*, at 388.

37 *Ibid.* at 390.

38 *Ibid.* at 375 to 405.

39 Sullivan, *supra*, note 13 at 123 to 150.

40 *Ibid.* at 135.

41 *Ibid.* at 125 and 136.

42 *Ibid.* at 136.

43 *Ibid.*

44 *Ibid.*

45 *Magor and St. Mellons Rural District Council v. Newport Corp.*, [1950] 2 All E.R. 1226 at 1236 (Eng. C.A.). But note what Lord Simonds said about this when the matter was heard in House of Lords: "This proposition. . . . cannot be supported. It appears to me to be a naked usurpation of the legislative function under the thin guise of interpretation." *Magor & St. Mellons Rural District Council v. Newport (Borough)*, [1952] A.C. 189 at 191.

46 *Air Canada v. British Columbia*, [1989] 1 S.C.R. 1161 at 1193 (S.C.C.).

47 Sullivan, *supra*, note 13 at 138, 139.

48 Coté, *supra*, note 14.

49 *Ibid.* at 405.

50 Ontario *Judicature Act*, R.S.O. 1970, c. 228.

51 *80 Wellesley St. East Ltd. v. Fundy Bay Builders Ltd.* (1972), 25 D.L.R. (3d) 386 (Ont. C.A.).

52 *Ibid.* at 388-390.

53 Sarra, *supra*, note 1.

54 *Dylex Ltd., Re* (1995), 31 C.B.R. (3d) 106 at 110 (Ont. Gen. Div. [Commercial List]); *Olympia & York Developments Ltd.* (2001), [2001] O.J. No. 3394, 2001 CarswellOnt 2954 (Ont. S.C.J. [Commercial List]); additional reasons at (2001), 2001 CarswellOnt 4739 (Ont. S.C.J. [Commercial List]); affirmed (2003), 2003 CarswellOnt 5210 (Ont. C.A.). *NsC Diesel Power Inc., Re* (1990), 79 C.B.R. 1 (N.S. T.D.); *Westar Mining Ltd., Re* (1992), 14 C.B.R. (3d) 88 (B.C. S.C.); *Interpretation Act*, R.S.C. 1985, c. I-21, s.12.

55 Sarra, *supra*, note 1.

56 David M. Walker, *The Oxford Companion to Law* (Oxford: Clarendon Press, 1980) *s.v.* discretion.

57 See: J.A.G. Griffith, *The Politics of the Judiciary* (5th ed.) (London: *Fontana Press*, 1997) at 340 where the author quotes "And in Duport Steels Ltd. v. Sirs Lord Scarman said: 'If people and parliament come to think that the judicial power is to be confined by nothing other than the Judge's sense of what is right . . . confidence in the judicial system will be replaced by fear of it becoming uncertain and arbitrary in its application. Society will then be ready for Parliament to cut the power of the judges.'". There is also the old saying that "Capital is a coward; money flees uncertainty."

58 Aharon Barak, *Judicial Discretion* (New Haven: Yale University Press, 1987) at 7.

59 *Ibid.* at 7-9.

60 B. McLachlin, "Rules and Discretion in Governance of Canada", (1992) 56 Sask.L.Rev. 167 at 170-171.

61 *Doiron v. Haché*, 2005 NBCA 75, 290 N.B.R. (2d) 79, ¶57 (N.B. C.A.). Borins J.A quotes Chief Justice Barak in his dissenting judgment in *Wong v. Lee* (2002), 58 O.R. (3d) 398 (Ont. C.A.).

62 The Honourable Mr. Justice Robert J. Sharpe, "The Application and Impact of Judicial Discretion in Commercial Litigation" (1997-98) 17 Advocates' Soc. J. No. 1, 4-11.

63 *Wong v. Lee*, *supra*, note 61.

64 *Tolofson v. Jensen*, [1994] 3 S.C.R. 1022 (S.C.C.)

65 *Royal Oak Mines Inc., Re* (1999), 1999 CarswellOnt 792 (Ont. Gen. Div. [Commercial List]). *United Used Auto & Truck Parts Ltd., Re* (1999), 12 C.B.R. (4th) 144 (B.C. S.C. [In Chambers]); affirmed (2000), [2000] B.C.J. No. 409, 16 C.B.R. (4th) 141, 2000 CarswellBC 414 (B.C. C.A.); leave to appeal allowed (2000), [2000] S.C.C.A. No. 142, 2000 CarswellBC 2132, 2000 CarswellBC 2133 (S.C.C.). In the matter of a Bankruptcy Proposal of *Bearcat Explorations Ltd.* (2004), 2004 CarswellAlta 1183 (Alta. Q.B.); *Charon Systems Inc. / Charon Systemes inc., Re* (2001), [2001] O.J. No. 5129, 2001 CarswellOnt 4556 (Ont. S.C.J.). In exercising its discretion, the court will consider: adequate notice to affected creditors; sufficient disclosure; timeliness of the request; the prospects for a viable restructuring; balancing the prejudice to stakeholders; and the principle of granting

priority financing as an extraordinary remedy; *Les Boutiques San Francisco Incorporées, Re* (2003), [2003] Q.J. No. 18940, 2003 CarswellQue 13882 (Que. S.C.).

66 *United Used Auto & Truck Parts Ltd., ibid.*

67 The Hon. R. P. Kerans, "Standards of Review employed by Appellate Courts" (Edmonton: Juriliber, 1994) at 134. See also the Hon. R.P. Kerans and K.M. Wiley *Standards of Appellate Review Employed by Appellate Courts* (2d ed.) (Edmondton: Juriliber, 2006) at 228.

68 *Ibid.*

69 Lord Diplock in *Hadmor Productions Ltd. v. Hamilton* (1982), [1982] 1 All E.R. 1042 at 1046, [1983] 1 A.C. 191 at 220 (U.K. H.L.), cited by Bayda C.J.S. in *Smart v. South Saskatchewan Hospital Centre* (1989), 75 Sask. R. 34 (Sask. C.A.) beginning at para. 22.

70 *Naneff v. Con-Crete Holdings Ltd.* (1995), 23 O.R. (3d) 481 (Ont. C.A.).

71 Ontario *Business Corporations Act*, R.S.O. 1990, c. B.16, s. 248.

72 *Naneff v. Con-Crete Holdings Ltd.*, *supra*, note 70 at 488-91.

73 *Ibid.*, at 491, 492.

74 *Ibid.*, at 493.

75 Stephen Waddams, "Judicial Discretion", (2001) 1 Oxford University Commonwealth Law Journal 58 at 60. See *Skeena*, *supra*, note 10 and *Stelco*, *supra*, note 6 as examples.

76 *Waddams, ibid.*, at 64.

77 *Algoma Steel Inc., Re* (2001), [2001] O.J. No. 1943, 25 C.B.R. (4th) 194, 2001 CarswellOnt 1742, ¶8 (Ont. C.A.); *Pacific National Lease Holding Corp., Re* (1992), 15 C.B.R. (3d) 265 (B.C. C.A. [In Chambers]); *Stelco*, *supra*, note 6 at para. 24, citing *Country Style Food Services Inc., Re* (2002), [2002] O.J. No. 1377, 158 O.A.C. 30, 2002 CarswellOnt 1038, ¶15 (Ont. C.A. [In Chambers]).

78 *Stelco, ibid.*

79 *Algoma*, *supra*, note 77 at para. 8.

80 *Sullivan*, *supra*, note 13 at 229.

81 [1995] 1 S.C.R. 3 at 24 (S.C.C.).

82 *Stelco*, *supra*, note 6 at paras. 35-36, citing *Skeena*, *supra* note 10.

83 *Stelco*, *ibid.*, at para. 38.

84 *Ibid.*, at para. 44.

85 *Ibid.*

86 Waddams, *supra*, note 75 at 59.

87 *Ibid.*

88 *Ibid.*

89 R. Dworkin, *Taking Rights Seriously* (Cambridge: Harvard University Press, 1977).

90 R. Dworkin, *Hard Cases* (1975) 88 Harv. L. Rev. 1057.

91 R. Dworkin, *Taking Rights Seriously*, (Cambridge: Harvard University Press, 1977, 1978 re-printing) at 81.

92 H.L.A. Hart, *The Concept of Law* (2d ed.) (Oxford: Clarendon Press, 1994) at 272-273.

93 Kerans and Willey, *supra*, note 67 at 215 & 216.

94 Waddams, *supra*, note 75 at 59.

95 *Skeena*, *supra*, note 10 at para. 46.

96 Sarra, *supra*, note 1.

97 *Ibid.*

98 *Olympia & York Developments Ltd. (Trustee of) v. Olympia & York Realty Corp.* (2001), [2001] O.J. No. 3394, 2001 CarswellOnt 2954 (Ont. S.C.J. [Commercial List]); additional reasons at (2001), 2001 CarswellOnt 4739 (Ont. S.C.J. [Commercial List]); affirmed (2003), 2003 CarswellOnt 5210 at 1 (Ont. C.A.).

99 *Quintette Coal Ltd. v. Nippon Steel Corp.* (1990), 2 C.B.R. (3d) 303 at 314 (B.C. C.A.); leave to appeal refused (1991), 7 C.B.R. (3d) 164 (note) (S.C.C.).

100 Waddams, *supra*, note 75 at 61.

101 *Re Canadian Airlines Corp.* (2000), [2000] A.J. No. 771, 2000 CarswellAlta 662 (Alta. Q.B.); leave to appeal refused (2000), [2000] A.J. No. 1028, 2000 CarswellAlta 919 (Alta. C.A. [In Chambers]); affirmed (2000), 2000 CarswellAlta 1556 (Alta. C.A.); leave to appeal refused (2001), 2001 CarswellAlta 888, ¶144 (S.C.C.); *Anvil Range Mining Corp., Re* (1998), 1998 CarswellOnt 5319, ¶2, Blair J. (Ont. Gen. Div. [Commercial List]). See also *Skydome Corp., Re* (1998), 1998 CarswellOnt 5922 (Ont. Gen. Div. [Commercial List]); *Enterprise Capital Management Inc. v. Semi-Tech Corp.* (1999), 1999 CarswellOnt 2213, ¶21, 22 (Ont. S.C.J. [Commercial List]); *Royal Bank v. Fracmaster Ltd.* (1999), 1999 CarswellAlta 539, ¶36, 40 (Alta. C.A.).

102 Janis Sarra, *Creditor Rights and the Public Interest, Restructuring Insolvent Corporations* (Toronto, University of Toronto Press, 2003).

103 *Skydome Corp., Re* (1998), 1998 CarswellOnt 5922 (Ont. Gen. Div. [Commercial List]).

104 *MEI Computer Technology Group Inc., Re* (2005), [2005] Q.J. No. 5744, 2005 CarswellQue 3675 (Que. S.C.) at para. 18, citing the Court of Appeal in *Stelco.*, *supra*, note 6 at para. 32 and *United Used Auto & Truck Parts Ltd., Re* (2000), [2000] B.C.J. No. 409, 2000 CarswellBC 414 (B.C. C.A.); leave to appeal allowed (2000), 2000 CarswellBC 2132, ¶12, 19-20 (S.C.C.).

105 I.H. Jacob, "The Inherent Jurisdiction of the Court" (1970), 23 Current Legal Problems 23. This article has been quoted with approval in *Assn. of Parents for Fairness in Education, Grand Falls District 50 Branch v. Société des Acadiens du Nouveau-Brunswick Inc.*, [1986] 1 S.C.R. 549 (S.C.C.) and in numerous lower court decisions.

106 *MacMillan Bloedel Ltd. v. Simpson*, [1995] 4 S.C.R. 725, ¶29 (S.C.C.).

107 Jacob, *supra*, note 105 at 27-28.

108 *Ibid.* at 23-24.

109 *Ibid.*, at 50-52.

110 *Ibid.*

111 *Ibid.*

112 *Assn. of Parents for Fairness in Education, Grand Falls District 50 Branch v. Société des Acadiens du Nouveau-Brunswick Inc.*, [1986] 1 S.C.R. 549, 27 D.L.R. (4th) 406 (S.C.C.).

113 *British Columbia Telephone Co. v. Shaw Cable Systems (B.C.) Ltd.*, [1995] 2 S.C.R. 739, 183 N.R. 184 (S.C.C.).

114 *St. Anne-Nackawic Pulp & Paper Co. v. C.P.U., Local 219*, [1986] 1 S.C.R. 704; *Weber v. Ontario Hydro*, [1995] 2 S.C.R. 929 (S.C.C.).

115 *Hill v. Church of Scientology of Toronto*, [1995] 2 S.C.R. 1130, 126 D.L.R. (4th) 129 (S.C.C.).

116 *Western Canadian Shopping Centres Inc. v. Dutton*, [2001] 2 S.C.R. 534 (S.C.C.)

117 K. Yamauchi: *The Court's Inherent Jurisdiction and the CCAA: A Beneficent or Bad Doctrine?*, (2004) 40 C.B.L.J. (Part Number 2) at 250; Janis P. Sarra: *Judicial Exercise of Inherent Jurisdiction Under the CCAA*, (2004) 40 C.B.L.J. (Part Number 2) at 280.

118 *Westar Mining Ltd., Re* (1992), [1992] B.C.J. No. 1360, 1992 CarswellBC 508, [1992] 6 W.W.R. 331 (B.C. S.C.).

119 *Ibid.*

120 *Dylex*, *supra*, note 54.

121 *Residential Warranty Co. of Canada Inc., Re* (2006), [2006] A.J. No. 349, 2006 CarswellAlta 383, 21 C.B.R. (5th) 57 (Alta. Q.B.); affirmed (2006), [2006] A.J. No. 1304, 25 C.B.R. (5th) 38, 2006 CarswellAlta 1354 (Alta. C.A.).

122 *Ibid.*, at para. 26, citing s.183(1) of the BIA, which reads, in material part:

> 183.
> (1) The following courts are invested with such jurisdiction at law and in equity as will enable them to exercise original, auxiliary and ancilliary jurisdiction in bankruptcy and in other proceedings authorized by this Act during their respective terms, as they are now, or may be hereafter, held, and in vacation and in chambers: . . . (d) in the Provinces of New Brunswick and Alberta, the Court of Queen's Bench; . . .

123 *Ibid.*, at para. 26.

124 *Ibid.*

125 *Ibid.*, at para. 27, quoting from Mr. Justice Farley in *Canada (Minister of Indian Affairs & Northern Development) v. Curragh Inc.* (1994), 27 C.B.R. (3d) 148 (Ont. Gen. Div. [Commercial List]).

126 *Ibid.*, at para. 36.

127 *Ibid.*, at para. 59.

128 *Ibid.*, at para. 78.

129 *Ibid.*, at paras. 79, 80 and 81.

130 *Ibid.*, at paras. 80, 81, citing *Robert F. Kowal Investments Ltd. v. Deeder Electric Ltd.* (1975), 21 C.B.R. (N.S.) 201 (Ont. C.A.).

131 *Residential Warranty Co. of Canada Inc.*, *supra*, note 121 (C.A.).

132 *Ibid.*, at para. 20, citing *Baxter Student Housing Ltd. v. College Housing Cooperative Ltd.* (1975), [1976] 2 S.C.R. 475 at 480 (S.C.C.); *Wasserman, Arsenault Ltd. v. Sone* (2002), 33 C.B.R. (4th) 145 (Ont. C.A.); additional reasons at (2002), 2002 CarswellOnt 3230 (Ont. C.A.). In *Wasserman*, the trustee applied for an increase in fees in a summary administration bankruptcy. Rule 128 of the BIA Rules caps the trustee's fees in summary administration bankruptcies with no permissive or

discretionary language. Both the Ontario Superior Court and the Ontario Court of Appeal concluded that inherent jurisdiction could not be used to conflict with that legislative expression.

133 *Ibid.*, at para. 21.

134 *Ibid.*, citing *Tlustie, Re* (1923), 3 C.B.R. 654 (Ont. S.C.); *Canada (Minister of Indian Affairs & Northern Development) v. Curragh Inc.* (1994), 27 C.B.R. (3d) 148 (Ont. Gen. Div. [Commercial List]).

135 *Ibid.*, citing *Olympia & York Developments Ltd., Re* (1997), 18 C.B.R. (4th) 243 (Ont. Bktcy.); affirmed (1998), 1998 CarswellOnt 3408 (Ont. C.A.); leave to appeal refused (1999), 123 O.A.C. 399 (note) (S.C.C.); *City Construction Co., Re* (1961), 2 C.B.R. (N.S.) 245 (B.C. C.A.); *Canada v. Curragh*, *supra*, note 125.

136 *Ibid.*, at para. 41.

137 *Re United Used Auto*, *supra*, note 65.

138 *Skeena*, *supra*, note 10.

139 *Stelco*, *supra*, note 6 at para. 34.

140 *Ibid.*, at para. 35, citing Farley J. in *Royal Oak Mines Inc., Re* (1999), [1999] O.J. No. 864, 1999 CarswellOnt 792, ¶4 (Ont. Gen. Div. [Commercial List]).

141 *Ibid.*, at para. 52; *Canada Business Corporations Act*, R.S.C. 1985, c. C-44 (CBCA).

142 *Ibid.*, at para. 48.

143 *Ivaco Inc., Re* (2006), 275 D.L.R. (4th) 132 (Ont. C.A.); leave to appeal allowed (2007), 2007 CarswellOnt 2855 (S.C.C.).

144 *Mine Jeffrey inc., Re* (2003), [2003] Q.J. No. 264, 2003 CarswellQue 90, 40 C.B.R. (4th) 95 (Que. C.A.).

145 Coté, *supra*, note 14 at 27-28.

146 *GMAC*, *supra*, note 12 at para. 2.

147 *Ibid.*, at para. 45. There was one dissenting opinion by Deschamps, J.

148 *Ibid.*, at para. 47.

149 *Ibid.*, at para. 50.

150 *Ibid.*, at para. 51.

151 *Big Sky Living Inc., Re* (2002), 37 C.B.R. (4th) 42 (Alta. Q.B.), in which the court held at para. 57 that an applicant had established that it is entitled to an interim receivership order in accordance with s. 47 of the BIA. However, the court held that the order tendered was overly broad, and overly declaratory and legislative in nature, and that it purported to affect in general terms the rights of broad and undefined classes of parties that had not received notice of this application. It went far beyond what was necessary for the protection of the estate of the debtor and attempted to provide the interim receiver with immunities and protections that are not authorized by statute.

152 *Skeena*, *supra*, note 10; *Stelco*, *supra*, note 6.

153 Sarra, *supra*, notes 1 and 102.

154 See for example, the oppression remedy provision discussed earlier.

End of Document

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 PT HOLDCO, INC., PRIMUS TELECOMMUNICATIONS CANADA, INC., PTUS, INC., PRIMUS TELECOMMUNICATIONS, INC., AND LINGO, INC.

Court File No. CV-16-11257-00CL

ONTARIO
SUPERIOR COURT OF JUSTICE
COMMERCIAL LIST

Proceeding commenced in Toronto

RESPONDING BOOK OF AUTHORITIES OF THE APPLICANTS
(Returnable August 9, 2016)

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