Court File No. CV-17-11846-00CL

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 SEARS CANADA INC., 9370-2751 QUÉBEC INC., 191020 CANADA INC., THE CUT INC., SEARS CONTACT SERVICES INC., INITIUM LOGISTICS SERVICES INC., INITIUM COMMERCE LABS INC., INITIUM TRADING AND SOURCING CORP., SEARS FLOOR COVERING CENTRES INC., 173470 CANADA INC., 2497089 ONTARIO INC., 6988741 CANADA INC., 10011711 CANADA INC., 1592580 ONTARIO LIMITED, 955041 ALBERTA LTD., 4201531 CANADA INC., 168886 CANADA INC., AND 3339611 CANADA INC.

BOOK OF AUTHORITIES OF THE MONITOR
(Transfer Under Value Claim Motion)
(returnable December 3, 2018)

November 20, 2018

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TAB 1

Case Name:

Verdellen v. Monaghan Mushrooms Ltd.

Between
Jack Verdellen, Applicant, and
Monaghan Mushrooms Ltd., Pricewaterhousecoopers Inc.,
Respondents

[2011] O.J. No. 4489

2011 ONSC 5820

97 C.P.R. (4th) 196

Court File No. CV-11-9162-CL

Ontario Superior Court of Justice
Commercial List

F.J.C. Newbould J.

Heard: September 27, 2011.
Judgment: October 7, 2011.

(49 paras.)

Intellectual property law -- Patents -- Ownership -- Transfer or assignment -- Application by Verdellen for declaration of ownership of patent rights dismissed -- Applicant claimed agreement with former employer conferred rights outside of North America in respect of horticultural invention -- Former employer subsequently sought creditor protection and was sold to respondent -- Even if enforceable agreement was proven, it conferred equitable rights to applicant rather than legal rights -- Agreement was void, as respondent took title to rights as bona fide purchaser for value without notice of applicant's claimed interest -- Otherwise, no protection conferred to respondent under s. 51 of Patent Act regarding rights outside of Canada -- Patent Act, s. 51.

Application by Verdellen for a declaration of ownership of patent rights. The applicant was a consultant formerly employed by Rolland Farms, a company placed under creditor protection in December 2008 and subsequently sold to the respondent, Monaghan Mushrooms, in September

2009. The sale closed in November 2009 under an amended vesting order dated October 2009. The applicant claimed ownership of patent rights outside of North America for the invention of a method of inhibiting green mould in mushrooms. The applicant relied on an oral and written agreement reached with Rolland in December 2008, one week prior to the initial creditor protection order. The applicant claimed that he and the president of Rolland orally agreed he would own the rights of whatever he invented provided Rolland was able to receive the benefits of the rights in North America. He claimed that the agreement was reduced to writing when he informed the president of his intent to leave the company. A copy of the agreement was dated three days after Rolland received a notice of intention to enforce security by a creditor. The respondent submitted that the applicant was unable to establish an enforceable agreement with Rolland due to lack of agreement on essential terms, an absence of consideration, and no evidence of communication of acceptance. The respondent submitted that it acquired the patent rights in question in good faith for value without notice of any rights of the applicant under a court-ordered process in which it received a vesting order. The respondent submitted that if an agreement existed, it was void under s. 51 of the Patent Act and as a preference under s. 95 of the Bankruptcy and Insolvency Act.

HELD: Application dismissed. It was not possible to determine the existence of a binding agreement due to contested factual issues incapable of resolution on an application. Assuming a binding agreement existed, the agreement on its wording conferred equitable rights to the applicant rather than legal. The wording of the agreement of purchase and sale and the vesting order clearly covered the worldwide patent rights for the invention in question. The respondent purchased the rights for value without notice. The publicly available information regarding ownership of the invention and any related patent information disclosed Rolland as the owner. The respondent's due diligence prior to closing was consistent with the publicly available information. At no time was the respondent aware of any interest of the applicant in the patent rights. Any purported agreement between Rolland and the applicant was void, as the respondent took title to the patent rights free and clear of any equitable interest of the applicant. No protection was conferred to the respondent under s. 51 of the Patent Act involving patent rights outside of Canada. The respondent had no status to void the agreement as a preference under s. 95 of the Bankruptcy and Insolvency Act.

Statutes, Regulations and Rules Cited:

Bankruptcy and Insolvency Act, R.S.C. 1985, c. B-3, s. 38, s. 95

Companies' Creditors Arrangement Act, R.S.C. 1985, c. C-36, s. 36.1

Patent Act, R.S.C. 1985, c. P-4, s. 49, s. 50, s. 51

Patent Rules, s. 59

Counsel:

Patrick J. Cotter, for the applicant.

Paul J. Martin and Sarah J. Armstrong, for the respondent Monaghan Mushrooms Ltd.

T. Van Klink, for the respondent PricewaterhouseCoopers Inc.

---

1 F.J.C. NEWBOULD J.:-- The applicant Jack Verdellen applies for a declaration that he is the owner of certain patent rights outside of North America for an invention which involves a method of inhibiting green mould in mushrooms. The invention was said to have occurred while Mr. Verdellen was employed by Rol-land Farms Limited ("Rolland"). Mr. Verdellen claims ownership under an agreement between him and Rolland said to have been negotiated orally and put in writing dated December 1, 2008

2 Rolland applied for protection under the CCAA on December 10, 2008 and the Initial Order was made that day. A sale process in the CCAA proceedings was undertaken and the respondent Monaghan Mushrooms Ltd. ("Monaghan") purchased the business of Rolland under an agreement of purchase and sale dated September 21, 2009. That agreement closed on November 6, 2009 under an amended vesting order dated October 27, 2009. Monaghan takes the position that Mr. Verdellen cannot establish an agreement between him and Rolland and that Monaghan acquired the patent rights in question in good faith for value without notice of any rights of Mr. Verdellen to the patent rights under a court ordered process that provided Monaghan with a vesting order. Monaghan also takes the position that if there were an agreement, it would be void under s. 51 of the Patent Act and as a preference under s. 95 of the BIA.

Existence of agreement

3 Mr. Verdellen's evidence is that he commenced work at Rolland as a consultant in 1994- 1995 and became Vice-President, Production in November 2006. His evidence is that at that time, he orally agreed with Mr. Vander Pol, the president and chief executive officer of Rolland, that he would own the rights to whatever he invented provided that Rolland was able to get the benefit of the rights in North America. In July 2007 he and another Rolland employee invented materials and methods to be used for the prevention and/or control of green mould in the production of mushrooms.

4 Mr. Verdellen's further evidence is that in late 2008 he told Mr. Vander Pol that he intended to leave the company and go back to Holland but that in order to keep him, a proposal was made by Rolland in writing in a document dated December 1, 2008 which confirmed his ownership of the invention and the patent rights outside of North America. The contractual rights claimed by Mr. Verdellen are contained in a document dated December 1, 2008 signed by Mr. Vander Pol on behalf of Rolland and by Mr. Verdellen. Mr. Verdellen is unable to say when he signed the document. He has never produced the original document. The date of December 1, 2008 is three days after BMO

delivered a notice of intention to enforce security against Rolland and shortly before Rolland commenced its CCAA proceedings.

5 The December 1, 2008 document includes the following:

> The information below summarizes how the R&D findings are to be handled to the mutual benefit of Rol-land Farms and Jack Verdellen:
>
> It is jointly recognized that the R&D activities carried on to date would not have been possible without the combined efforts of Jack Verdellen, Nader Gheshlaghi and Rol-land Farms. Jack has provided the ideas, Nader has carried out the research and Rol-land has funded the activities.
>
> ...
>
> Given Jack's contributions to Rol-land's operations over the past 3 years, and given Rol-land's contributions to the R&D program over that same time period, Rol-land and Jack agree to the following settlement:
>
> * Rol-land will transfer the world rights to "Pepe" to Jack to continue with a world application.
> * Rol-land must retain the North American rights to "Pepe" in order to protect its competitive advantage.
>
> ...
>
> This agreement is not transferable without the written consent of both Jack Verdellen and Rol-land Farms

6 Monaghan refers to several pieces of evidence and suspicious circumstances to assert that there was never any agreement between Mr. Verdellen and Rolland. It also asserts that there was no agreement on all essential terms, there was no consideration flowing to Rolland and there is no evidence of communication of any acceptance by Mr. Verdellen to Rolland.

7 This is an application. In my view there are too many contested factual issues to determine at this stage whether or not there was a binding agreement between Mr. Verdellen and Rolland. During the course of the oral argument I made that determination.

8 What remains is whether on the assumption that a binding agreement as claimed by Mr. Verdellen was made, there are any grounds available to support a declaration of the rights of the parties.

Purchase agreement and vesting order

9 The agreement of purchase and sale dated September 21, 2009 between Rolland and Monaghan closed on November 6, 2009. Approval to the agreement and a vesting order was made on October 5, 2009 and an amended approval and vesting order was made on October 27, 2009. Mr. Verdellen takes the position that the agreement of purchase and sale did not transfer to Monaghan the rights to the patent outside of North America and further takes the position that if necessary, the vesting order should be amended to make that clear.

10 The agreement of purchase and sale provided for the sale of a number of assets, including the Intellectual Property. Intellectual Property was broadly defined as follows, in part:

> "Intellectual Property" means all of the intellectual property of whatever nature and kind owned by or licensed to the Vendor in respect of or associated with the Business as presently constituted, including all domestic and foreign trademarks, ... and all patents ... whether registered or unregistered, and all applications for registration thereof, and ... inventions ...; in which, for further certainty, includes ... all products, processes and inventions developed by or for or used by the Business in connection with the control or eradication of green mould disease, including any patent applications for strains of biological control for green mould for the treatment of spawn;

11 It is to be noted that this definition of Intellectual Property is in respect of the "Business". Mr. Verdellen asserts that the definition of Business in the agreement of purchase and sale excludes any patent rights outside of North America. Business is defined in the agreement to have the meaning set out in the recitals. The recital refers to the order under which the Monitor was authorized and directed to conduct a sale process for offers for the sale "of the mushroom production and marketing business" of Rolland. Mr. Verdellen asserts that because Rolland only carried on its mushroom business in North America, any patent rights outside of North America were not included in the agreement of purchase and sale.

12 I cannot accept that contention. The definition of Business in the agreement of purchase and sale as being "the mushroom production and marketing business" of Rolland by its language did not restrict that business to any particular locality or jurisdiction. The business of Rolland included making patent applications for the invention in question, being an invention to control or eradicate green mould disease. Prior to the sale, Rolland had filed an international PCT application, which was an application to commence exploiting patent rights throughout the world. That was part of its business.

13 On the day of the closing, Rolland executed and delivered to Monaghan an assignment of patent rights that specifically contained worldwide rights to the invention in question. The recitals in the assignment referred to the invention for which PCT and U.S. applications had been filed and recited that under the agreement of purchase and sale Rolland had agreed to sell that invention to Monaghan. The operative provisions of the assignment contained, in part, the following:

> The Assignor does hereby sell, assign and transfer to Monaghan and its successors and assigns:
>
> (i) all of Assignor's entire right, title and interest to the Patent, including any and all inventions described therein, and in any and all national phase patent applications, continuations-in-part, continuations, divisions, substitutes, re-issues, re-examinations, or extensions thereof, and all other applications for the Patent relating thereto which have been filed, or hereafter shall be filed in all the countries of the world, including in Canada;

14 It is clear in my view that the agreement of purchase and sale covered the worldwide patent rights for the invention in question.

15 The vesting order as amended vested in Monaghan the assets described in the agreement of purchase and sale. This included the worldwide patent rights for the invention in question. Thus the vesting order should not be amended.

Purchaser for value without notice

16 The evidence appears clear that prior to the closing of the purchase of the mushroom business by Monaghan from Rolland, the publicly available information regarding ownership of the invention in question and any related patent applications disclosed Rolland as the owner.

17 On February 26, 2008, a U.S. patent application was filed in which Mr. Verdellen and another Rolland employee named Nader Gheshlaghi were named as the applicants and inventors and Rolland was named as the assignee for the patent application. On March 18, 2008 Mr. Verdellen and Mr. Gheshlaghi executed a written assignment in favour of Rolland in which they assigned to Rolland Farms their entire right, title and an interest throughout the world in the inventions which were the subject of the U.S. patent application. This assignment was recorded in the U.S. patent office on May 13, 2008. Also on March 18, 2008 a power of attorney was signed by Rolland as assignee which indicated that Rolland was the owner of the U.S. application and this power of attorney was also recorded in U.S. patent office on May 13, 2008.

18 Prior to the closing of the purchase, Monaghan and its advisers conducted due diligence regarding the business to be acquired, including information on patents. All of the information provided to Monaghan was consistent with the publicly available information that Rolland held the

ownership interest in the patent rights in question. Also, at no relevant time was the Monitor aware of any interest of any third party, including Mr. Verdellen, in the patent rights and Mr. Verdellen never told the Monitor of his alleged interest even though a representative of the Monitor met with Mr. Verdellen on a number of occasions. At no relevant time did representatives of Rolland advice the Monitor or Monaghan of any alleged interest of Mr. Verdellen in the patent, including at a meeting on November 2, 2009, four days before the closing of the sale, which was held in part to address an issue of an apparent deletion of research and development from Rolland's computer system.

19 Counsel for Mr. Verdellen refers to evidence that on October 2, 2009 Mr. Verdellen met with a lawyer at Gowlings, the solicitors for Rolland dealing with patent applications for the invention in question, and told the lawyer that an international patent application filed under the Patent Cooperation Treaty by Rolland belonged to him. The lawyer, who was a junior lawyer not acting on the matter, advised Mr. Verdellen that there was a conflict and that the firm could not act for him. The lawyer made a memorandum to file. Although Rolland had authorized Gowlings to disclose all of the information in their patent files to Monaghan prior to closing, the physical files were not received by Monaghan until early December 2009, at least one month after the sale transaction closed. There is no evidence, however, that Monaghan was told by Gowlings or anyone else prior to the closing of Mr. Verdellen's alleged ownership interest in the patent.

20 In my view, it is clear from the evidence that prior to the closing of the purchase of the business by Monaghan from Rolland, Monaghan was never provided, nor did it learn of, any information of Mr. Verdellen's alleged interest in the patent, in spite of Monaghan's due diligence process.

21 Monaghan contends that if there is a binding agreement between Mr. Verdellen and Rolland regarding patent rights, the interest of Mr. Verdellen is equitable and that as Monaghan, is a *bona fide* purchaser for value without notice of the agreement between Mr. Verdellen and Rolland, it took title to the patent rights free and clear of any equitable interest of Mr. Verdellen.

22 The doctrine of *bona fide* purchaser for value without notice is described by Prof. Ziff in B. Ziff, *Principles of Property Law*, 5th ed. (Carswell: Toronto, 2010) at page 460 as follows:

> Equity acts on the conscience of the relevant parties; that is why a *bona fide* purchaser for value of the legal title who buys land without notice of an equitable interest will not be bound by that interest. The good faith purchaser has what we would now call a clear conscience, and the present of such a person can alter the ordering of rights.

23 Although this statement refers to land, there is no principled reason why the principle would not apply to any form of property. A contractual right to intellectual property is property not taken by physical possession. It is a chose in action. This is made clear from the judgment of Morden J.A. in *DiGuilo v. Boland*, [1958] O.R. 384 in which he sated the following:

> To determine the legal issue thus presented, it is necessary to consider the law relating to choses in action and their assignability, first in England then in Ontario. In *Torkington v. Magee*, [1902] 2 K.B. 427, Channell, J., said, at p. 430:-
>
>> 'Chose in action' is a known legal expression used to describe all personal rights of property which can only be claimed or enforced by action, and not in taking physical possession.
>
> The term covers multifarious rights, many diverse in their essential nature, such as debts, company shares, negotiable instruments and rights of action founded on tort or breach of contract.
>
> ...
>
> The nature of the rights of a purchaser under an agreement of sale of land should, at this point, be briefly considered. His rights are choses in action and are capable of assignment in equity: *Wood v. Griffith* (1818), 1 Swan. 43, at pp. 55-6. The right to specific performance was and is an equitable chose and the right to damages a legal chose in action.

24 See also Prof. Ziff at p. 76 in which he states that the right to assign choses took a long time to mature but eventually the scope of the category was extended to include a wide range of other intangibles, including copyrights, trademarks, patents etc.

25 Gordon Henderson, Q.C., at one time the undoubted leader of the intellectual property bar in Canada, described the doctrine of a *bona fide* purchaser for value without notice as it related to patents in G. Henderson, "Problems Involved in the Assignment of Patents and Patent Rights", *Canadian Patent Reporter,* Vol. 60, p. 237 at pp. 248-9 as follows:

> An equitable assignment exists where there is an agreement rather than a complete and absolute assignment.
>
> In equity (and therefore apart from s. 53 of the Patent Act) an assignee of a patent takes title subject to the equities. Accordingly, a subsequent purchaser of a patent who has knowledge of a prior equitable assignment takes title subject to the prior equitable interest. But an assignee who purchases a patent for valuable consideration without notice of a prior equitable assignment takes free and clear

of it.

26 The doctrine of *bona fide* purchaser for value without notice has been applied in intellectual property cases. See *R Griggs Group Ltd v. Evans (No 2),* [2005] Ch. 153, [2004] at para. 54.

27 What is the interest of Mr. Verdellen in his contract with Rolland, assuming the contract to exist? Mr. Verdellen takes the position that the agreement transferred the patent rights to him with no necessity for any further transfer, and he has attempted to have his rights under the agreement recognized in the European Patent Office based on that agreement.

28 Monaghan contends that Mr. Verdellen's interest under the agreement, assuming it to exist, is an equitable interest as the agreement states that Rolland "will transfer" the world patent rights to Mr. Verdellen. That is, it is an agreement to transfer those rights rather than an agreement under which the rights have been transferred to Mr. Verdellen. Monaghan compares the contract with an agreement of purchase and sale of land in which it is clear that the interest of the purchaser before closing is an equitable interest.

29 The agreement between Mr. Verdellen and Rolland is not as clear as a typical agreement of purchase and sale in which a future closing date is specified. However in my view, in the circumstances in which the agreement was made, and taking into account the express language "The information below summarizes how the R&D findings are to be handled ..." and "Rol-and will transfer ... to Jack", the agreement was an executory agreement in that the transfer did not take place in the agreement itself but rather was a promise that it would take place at some time in the future. Thus the interest of Mr. Verdellen under the contract was a chose in action and the right to specific performance was, as stated by Morden J.A., an equitable chose an action. That is, Mr. Verdellen rights under the contract, assuming they existed, were equitable rather than legal.

30 This notion of Mr. Verdellen's interest being an equitable interest is captured by the maxim when something is to be done under an agreement that "equity considers done what ought to be done". See *Re: Grant Forest Products Inc*. (2010), 101 O.R. (3d) 383 (C.A.), aff'g (2009), 58 C.B.R. (5th) 127.

31 In the circumstances, in my view, Monaghan is correct in its position that even if Mr. Verdellen had a binding contract with Rolland covering the patent rights in issue, Monaghan acquired those patent rights as a good faith purchaser without notice of Mr. Verdellen's rights and thus acquired them free and clear of any interest Mr. Verdellen might otherwise have had in them.

Section 51 of the Patent Act

32 Apart from the doctrine of being a bona fide purchaser for value without notice, Monaghan relies upon section 51 of the Patent Act to defeat any interest that Mr. Verdellen might otherwise have in the patent rights in dispute. That section, and the preceding two sections provide:

> **49**. (2) Where an applicant for a patent has, after filing the application, assigned his right to obtain the patent, or where the applicant has either before or after filing the application assigned in writing the whole or part of his property or interest in the invention, the assignee may register the assignment in the Patent Office in such manner as may be determined by the Commissioner, and no application for a patent may be withdrawn without the consent in writing of every such registered assignee.

> **50.** (2) Every assignment of a patent, and every grant and conveyance of any exclusive right to make and use and to grant to others the right to make and use the invention patented, within and throughout Canada or any part thereof, shall be registered in the Patent Office in the manner determined by the Commissioner.

> **51.** Every assignment affecting a patent for invention, whether it is one referred to in section 49 or 50, is void against any subsequent assignee, unless the assignment is registered as prescribed by those sections, before the registration of the instrument under which the subsequent assignee claims.

33 The effect of section 51 of the Patent Act seems obvious. In *Apotex Inc. v. Wellcome Foundation Ltd*., [2000] F.C.J. No. 1770 (F.C.A.) Rothstein J.A. stated at para. S00:

> Having regard to both sections [Sections 50(2) and 51], it is clear that a purpose of registration under subsection 50(2) is to secure an assignee's priority as against subsequent assignees. Failure to register will deprive an assignee of priority against subsequent assignees and, as between them, an unregistered assignment is "void".

34 Mr. Verdellen takes the position that section 51 has no application to the patent rights in question, being the worldwide rights outside of North America, as he asserts that the section deals only with registration in Canada.

35 Monaghan looks to the process in which a foreign patent application was made and then brought into Canada and contends that the effect of the Patent Rules under the Patent Act makes section 51 of the Patent Act applicable to the foreign patent rights outside of North America.

36 The Patent Cooperation Treaty ("PCT") is an international patent law treaty to which Canada is a signatory providing a unified procedure for filing patent applications to protect inventions in each of its contracting states. A patent application filed under the PCT is called an international application, or PCT application. The PCT provides for the filing of one patent application, in one language, with effect in each of its contracting states, instead of filing several separate national

and/or regional patent applications. A PCT application does not itself result in the grant of a patent, since there is no such thing as an "international patent" or a "PCT patent". A PCT application, which establishes a filing date in all contracting states, must be followed up with the step of entering into national and/or regional phases in order to proceed towards the grant of national and/or regional patents.

37 On February 26, 2009, a PCT application was filed by Rolland in the Canadian Intellectual Property Office. On August 10, 2010, after the completion of its purchase from Rolland, Monaghan caused the PCT application to enter the national phase in Canada so as to become a Canadian patent application. This was filed with the Canadian Intellectual Property Office. At the same time Monaghan registered with that office the assignment of patent rights that it had acquired from Rolland on the closing of its purchase from Rolland.

38 Section 59 of the Patent Rules under the Patent Act provide:

> 59. When an international application becomes a PCT national phase application, the application shall thereafter be deemed to be an application filed in Canada and the Act and these Rules shall thereafter apply in respect of that Application.

39 Thus by virtue of that section, when the PCT application became a Canadian national phase application on August 10, 2010, the application was deemed to be an application filed in Canada and the Patent Act thereafter applied to it.

40 Monaghan asserts that once engaged, section 51 does not merely prohibit a prior unregistered assignment from affecting title to a Canadian patent or application in respect of which a subsequent assignment has been registered but rather renders the entire prior unregistered assignment "void as against any subsequent assignee". Therefore, Monaghan asserts, the December 1, 2008 agreement relied upon by Mr. Verdellen, which was not registered before August 10, 2010, is void as against the assignment from Rolland registered on that day by Monaghan both in respect of Canadian patent or application rights and such rights elsewhere in the world.

41 It is understandable that when an international PCT application becomes a national phase application in Canada, the national phase application becomes subject to the Patent Act and a contest between two claimants to those Canadian patent rights would be governed by the registration provisions in section 51 of the Patent Act. Can it be said, however, that a contest between those two claimants to foreign patent rights would be governed by section 51 of the Patent Act? In my view it cannot.

42 While the Parliament of Canada has the legislative competence to enact laws having extraterritorial effect, it is presumed not to intend to do so, in the absence of clear words or necessary implication to the contrary. See *Society of Composers, Authors & Music Publishers of Canada v. Canadian Assn. of Internet Providers,* [2004] 2 S.C.R. 427 at para. 54 per Binnie J. Neither section 51 of the Patent Act nor section 59 of the Patent Rules expressly state that the

provisions of section 51 are applicable to a contest between patent claimants in a foreign jurisdiction, nor can it be said that it is a necessary implication to come to that result. In my view it would be in the interests of international comity to leave such foreign contests to the laws of the foreign states in question.

43 Monaghan refers to the European Patent Convention which provides that the applicable law in each Contract State in Europe governs a patent application and to the provisions of the U.K. Patent Act which contain provisions similar to section 51 of the Canadian Patent Act. It also refers to similar provisions in the Australian Patent Act. It does so because Mr. Verdellen has asserted ownership of the patent rights in both Europe and in Australia. Monaghan asserts that the application of section 51 of the Patent Act would thus be consistent with international patent practice. To my mind the fact that these other jurisdictions have provisions governing a contest between patent claimants in those jurisdictions is all the more reason based on principles of international comity to construe section 59 of the patent rules and section 51 of the Patent Act as not being applicable to disputes between patent claimants in those jurisdictions.

44 Thus in my view Monaghan gains no protection for its patent rights against Mr. Verdellen under section 51 of the Patent Act insofar as those rights involve the rights to Europe or elsewhere outside of Canada.

S. 95 preference

45 Monaghan takes the position that the purported agreement relied upon by Mr. Verdellen is dated December 1, 2008, within three months of the filing of the CCAA application, and is therefore void under section 95 of the BIA. Section 95 of the BIA is applicable to a proceeding under the CCAA by virtue of section 36.1 of the CCAA.

46 In my view Monaghan has no status to act under section 95 the BIA. The right under section 95 to commence an application is one that in bankruptcy can only be brought by a trustee in bankruptcy. See *Tucker v. Aero Inventory (UK) Ltd.* [2011] O.J. No. 3816 per Morawetz J. at paras. 137 and 166. By virtue of section 36.1 of the CCAA, it is the Monitor who would have the right to make an application under section 95 of the BIA. Monaghan is not a creditor and thus would not be in a position to apply under section 38 of the BIA, also applicable to a CCAA proceeding, to acquire any right of action under section 95 of the BIA from the Monitor.

47 Even if Monaghan had status to act under section 95 the BIA, it would not be possible on an application to make a determination of the matter as there are facts in dispute.

Conclusion

48 The application of Mr. Verdellen is dismissed. The cross-application of Monaghan is allowed in part. It is declared that the purported agreement of December 1, 2008 between Mr. Verdellen and Rolland and any purported oral agreement between them regarding the same matters, is void as

against Monaghan as a *bone fide* purchaser for value from Rolland without notice of any such agreements,

49 Monaghan is entitled to its costs. If the costs cannot be agreed, Monaghan may make written submissions, not exceeding three pages in length, along with a proper cost outline, within 10 days and Mr. Verdellen may make reply submissions, no longer than three pages in length, within a further 10 days.

F.J.C. NEWBOULD J.

TAB 2

Case Name:

Cash Store Financial Services (Re)

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 The Cash Store Financial Services, The Cash Store Inc., TCS Cash Store Inc., Instaloans Inc., 7252331 Canada Inc., 5515433 Manitoba Inc., 1693926 Alberta Ltd. doing business as "the Title Store"

[2014] O.J. No. 3639

2014 ONSC 4326

243 A.C.W.S. (3d) 626

16 C.B.R. (6th) 261

2014 CarswellOnt 10776

31 B.L.R. (5th) 313

Court File No. CV-14-10518-00CL

Ontario Superior Court of Justice

G.B. Morawetz J.

Heard: June 11 and 16, 2014.
Judgment: August 5, 2014.

(133 paras.)

Creditors and debtors law -- Creditor-debtor relationship -- Debt -- What constitutes -- Loans -- Motion by third party lenders (TPLs) for a declaration that certain funds were owned by them dismissed -- Cash Store was a payday lending company operating under Companies' Creditors Arrangement Act protection -- On paper, Cash Store obtained funding from the TPLs which Cash Store, as broker, then loaned to Cash Store customers -- Customers paid an interest rate of 59 per

cent and the interest payments were to flow to the TPLs -- However, in reality, Cash Store instead provided the TPLs with payments equivalent to 17.5 per cent per annum -- The relationship was therefore a debtor-creditor relationship.

Motion by third party lenders (TPLs) for a declaration that certain property was owned by them free of any interests or claims of any creditor. Cash Store Financial Services was a payday lending company operating under Companies' Creditors Arrangement Act protection. On paper, Cash Store obtained funding from the TPLs which Cash Store, as broker, then loaned to Cash Store customers. The TPLs took the position that they entrusted millions of dollars to Cash Store for the sole purpose of brokering loans and that at all times the TPLs retained ownership of their funds.

HELD: Motion dismissed. Cash Store customers would pay a rate of interest of 59 per cent and the interest payments were to flow through to the TPLs. However, in reality, that did not happen. Instead, Cash Store provided a rate of return equivalent to 17.5 per cent per annum. Those payments were accepted by the TPLs. As a result, the parties altered the relationship from what was set out in the Broker Agreements and the relationship between the TPLs and Cash Store was a debtor-creditor relationship.

Statutes, Regulations and Rules Cited:

Assignments and Preferences Act, R.S.O. 1990, c. A.33,

Bankruptcy and Insolvency Act, R.S.C. 1985, c. B-3, s. 38, s. 95, s. 96

Companies' Creditors Arrangement Act, R.S.C. 1985, c. C-36, s. 11.52, s. 36.1

Fraudulent Conveyances Act, R.S.O. 1990, c. F.29,

Counsel:

Jeremy Dacks, for the Chief Restructuring Officer of the Applicants.

Heather Meredith, for the FTI Canada Consulting Canada Inc., Monitor.

Robert W. Staley and *Raj S. Sahni* and *Jonathan Bell,* for 0678786 B.C. Ltd.

Alan Merskey and *Orestes Pasparakis*, for Coliseum Capital Partners LP, Coliseum Capital Partners II LP, Blackwell Partners LLC, Alta Fundamental Advisors Master LP and the Ad Hoc Committee of Cash Store Noteholders in their representative capacities as DIP Lenders, First Lien Noteholders and Holders of Senior Secured Notes.

Brendan O'Neill, for the Ad Hoc Committee of Cash Store Noteholders.

Andrew Hatnay, *James Harnum* and *Adrian Scotchmer*, for Tim Yeoman.

Brett Harrison, for Trimor Annuity Focus LP, No. 5.

ENDORSEMENT

G.B. MORAWETZ J.:--

Introduction

1 Cash Store (as defined below) is a payday lending company operating under CCAA protection.

2 Cash Store is not a conventional lender. When operating in the "normal course", Cash Store acts as a broker charging a fee of 23% of funds advanced, paid by its customers with the fee being taken directly off the loan proceeds.

3 On paper, Cash Store obtains funding from sources which include a number of third party lenders ("TPLs"). On paper, these TPLs provide Cash Store with funds which Cash Store, as broker, then lends to Cash Store customers. On paper, the loans are assigned to the TPLs. On paper, the TPLs "own" all payments received from the customers. These payments are comprised of principal and interest. Interest is charged at a rate of 59% per annum. On paper, Cash Store is required to keep TPL funds segregated. On paper, the operating model leads to a conclusion that the relationship between TPLs and Cash Store is not a debtor-creditor relationship, but is one where Cash Store functions as a broker.

4 However, the manner in which Cash Store business operations were conducted differed substantially from that set out "on paper". Specifically, interest payments did not flow to the TPLs at the contract rate of 59% - or even at 59% less a bad debt expense, or after an allowance for impaired loans. Rather, Cash Store would make "voluntary payments" or "retention payments" at the rate of 17.5% (in some cases 20%) to the TPLs as "an inducement" to ensure the continued support of the TPLs.

5 Payments received from Cash Store customers were used in the operations of Cash Store. Cash Store did not keep payments that it received from its customers in a segregated account for TPLs. The TPLs did not audit the accounts of Cash Store.

6 Cash Store breached a number of contractual agreements. Cash Store defaulted on its obligations. The management team of Cash Store has departed and Cash Store has filed for protection under the CCAA. The parties that provided Cash Store with funds are now trying to recover those funds.

7 At the core of this motion is a dispute over whether these TPLs loaned their funds *to Cash Store*, which in turn made its own loans to its customers; or whether the funds were loaned by the TPLs *to Cash Store's clients*, with Cash Store merely operating as a broker. If the conclusion is the former, the TPLs must stand in line as creditors of Cash Store. If the latter is true, the TPLs argue they, and not Cash Store, are the beneficial owners of certain funds in the possession of Cash Store and of certain outstanding loans.

8 The circumstances, and the relief sought on this motion, are set out below. I begin with the relief sought by the various parties on the motion and cross motion. I then set out the relevant history of the CCAA proceedings, followed by the positions of the respective parties. Finally, I turn to an analysis of the issues.

I. Relief Sought

9 0678786 B.C. Ltd. (formerly the McCann Family Holding Corporation) ("McCann") is a TPL and brings this motion for a declaration that the following property (collectively, the "McCann Property"), including, without limitation, the McCann Loans as defined in the order of April 30, 2014 is owned by McCann free of any interests or claims of any creditor:

a. Any loans made in the name of any third party lender and brokered by the Cash Store Inc. and 1693926 Alberta Ltd. (collectively, "Cash Store") on behalf of their customers ("Customers") using funds made available by McCann for that purpose (the "McCann Funds");
b. Any advances originated by Cash Store and subsequently purchased with the McCann Funds;
c. Any loans or advances originated by Cash Store and subsequently assigned to McCann as capital protection or otherwise (together with (a) and (b) above, the "McCann Loans");
d. Any amounts received by Cash Store from its customers in repayment of the McCann Loans (the "McCann Receipts");
e. Any accounts receivable in respect of the McCann Loans (the "McCann Accounts Receivable"); and f. The McCann Funds.

10 Trimor Annuity Focus Limited Partnership No. 5 ("Trimor") is also a TPL and brings a similar motion for a declaration that the following property (the "Trimor Property") is owned by Trimor free of any interests or claims of any creditor of the Applicants:

a. Any loans made in the name of Trimor and brokered by the Cash Store on behalf of their Customers using funds made available by Trimor for that purpose (the "Trimor Funds");
b. Any advances originated by Cash Store and subsequently purchased with the Trimor Funds;
c. Any loans and advances originated by Cash Store and subsequently

assigned to Trimor as capital protection or otherwise (together with (a) and (b) above, the "Trimor Loans");

d. Any amounts received by Cash Store from its Customers in repayment of the Trimor Loans (the "Trimor Receipts");

e. Any accounts receivable in respect of the Trimor Loans (the "Trimor Accounts Receivable"); and f. The Trimor Funds.

11 The lenders under the Applicants' amended and restated Debtor and Possession Term Sheet, dated May 16, 2014, (collectively, the "DIP Lenders") bring a cross-motion for a declaration that:

i. the Applicants are the beneficial owners of funds described as "Trimor Funds", "McCann Funds", "Trimor Receipts" and "McCann Receipts" (collectively, the "Disputed Post-Filing Receipts") in the Fresh as Amended Notice of Motion of Trimor and the Fresh as Amended Notice of Motion of McCann (collectively, the "TPL Notices of Motion");

ii. the following transactions constitute preferences under applicable legislation:

1. the designation by the Applicants of any advances or loans, including brokered loans, as advances or loan in the names of Trimor or McCann; and
2. any assignment, whether as capital protection or otherwise, by the Applicants to Trimor or McCann, or in their names, of non-brokered loans made in the names of the Applicants (collectively, the "Reviewable Transactions").

iii. The Reviewable Transactions shall be reversed such that the Applicants are the beneficial owners of the assets described as "Trimor Loans", "Trimor Accounts Receivable", "McCann Loans" and "McCann Accounts Receivable" in the TPL Notices of Motion;

iv. Neither Trimor nor McCann shall take any steps to collect any advances or loans made to the Applicants' Customers, irrespective of whether such loans or advances have been designated in the name of Trimor or McCann or otherwise assigned to Trimor or McCann by the Applicants, and any recoveries or collections on such advances or loans by Trimor or McCann shall be deemed to be held in trust for the Applicants;

v. In the alternative to (ii) through (iv) above, declaring that no steps be taken by Trimor or McCann to assert an interest in, collect, or otherwise recover any of the advance or loans made to the Applicants' Customers, whether in the names of Trimor or McCann or otherwise, unless the Monitor determines not to challenge the Reviewable Transactions.

II. Background of CCAA Proceedings

12 On April 14, 2014, an initial order (the "Initial Order") was granted pursuant to the *Companies' Creditors Arrangement Act*, R.S.C. 1985, c. C-36 ("CCAA"), to the Cash Store Financial Services Inc. ("CSF"), Cash Store Inc., TCS Cash Store Inc., Instaloans Inc., 7252331 Canada Inc., 5515433 Manito Inc. and 1693926 Alberta Ltd. doing business as "The Title Store" (collectively, the "Applicants" or "Cash Store"), providing protections to the Applicants under the CCAA, and appointing FTI Consulting Canada Inc. as monitor (the "Monitor").

13 On April 15, 2014, an amended and restated Initial Order (the "Amended and Restated Initial Order") was granted, which, among other things, approved an interim CCAA credit facility (the "Initial DIP") by Coliseum Capital LP, Coliseum Capital Partners II LP, and Blackwell Partners LLC (collectively, "Coliseum"), and appointed Blue Tree Advisors Inc. as Chief Restructuring Officer of the Applicants (the "CRO").

14 On April 20, 2014, an order was granted providing certain protections for third party lenders ("TPLs") (McCann and Trimor are TPLs) specifically relating to repayments of loans bearing the name of, attributable to, or assigned to, McCann and Trimor and requiring the Applicants to maintain the $3 million minimum cash balance (the "Additional TPL Protection Order").

15 On May 13, 2014, the court granted an order (the "May 13 Order"), which extended the stay to May 16, 2014, approved a key employee retention plan and related charge, approved the cessation of the Applicants' brokered loan business (the "Broker Business") in all jurisdictions in which it was then carried out, and authorized the CRO, in consultation with the Monitor, to conduct an orderly cessation of such business.

16 On May 17, 2014, an order was granted extending the stay and approving an amended and restated term sheet providing for a DIP Facility by the following lenders (together, the "DIP Lenders"): Coliseum, Alta Fundamental Advisors, LLC, and certain members of the Ad Hoc Committee (the "Ad Hoc Committee") of the Applicants' 11 1/2% Senior Secured Notes (the "Notes").

17 The TPL protections and provisions of the Additional TPL Protection Order provide as follows:

a. A charge in favour of the TPLs (the "TPL Charge") in the amount of Cash Store's cash on hand as of the effective time of the Initial Order, as security for any valid trust or other proprietary claim of a TPL to such cash on hand;

b. A declaration that the TPLs' entitlement to TPL brokered loans in existence at the effective time of the Initial Order (the "TPL Brokered Loans") is to be determined based on the legal rights as they existed immediately prior to the effective time, and that post-filing treatment of

receipts is not relevant to determination of the TPLs alleged entitlement to or ownership of and will not prevent the TPLs from arguing that segregation would have been required by them, but for the Initial Order; and c. Restrictions on the treatment of post-filing receipts and new TPL Brokered Loans and requirements to keep certain minimum cash balances.

III. Facts

a. Monitor's Reports

18 As the Monitor noted in the pre-filing report, according to the Applicants the TPLs had provided approximately $42 million of funding (the "TPL Funds") over time in relation to various brokered loans. The original $42 million could be accounted for as follows:

a. Restricted cash (TPL Funds received by Cash Store that are not redeployed to other broker customers as referenced on Cash Store's financial statements), estimated to be approximately $14.7 million as at March 31, 2014; and b. Amounts on loan to Customers pursuant to the Broker Agreements (defined therein) of which approximately $8.5 million were "historic bad loans" which the Monitor understood were outstanding since at least 2012, unlikely to be recovered and all brokered with Trimor.

19 The Monitor is of the understanding that the relief sought by Trimor and McCann relates specifically to TPL Brokered Loans that existed immediately prior to the commencement of the CCAA proceedings and amounts collected by Cash Store in relation to the Brokered Loans after the commencement of the CCAA proceedings (the "TPL Post-Filing Receipts").

20 The Monitor also noted that the question of ownership of the TPL Brokered Loans and the specific relief sought on this motion may have broader implications on the question of compliance with regulatory restrictions and on potential class action claims arising therefrom.

21 The Monitor compiled and updated data relevant to these foregoing issues.

22 As of April 13, 2014 (the day before the Initial Order), TPL Brokered Loans in the following value were recorded in the Applicants' books and records:

a. $5.7 million of McCann loans, which included:

i. 673 loans with a total face value of $449,000 that were written off prior to April 13, 2014 all of which had been Cash Store direct loans that had been assigned to McCann; and ii. 7,855 line of credit loans in Ontario with a face value of $5.26 million, all of which had been

written in Trimor's name and subsequently transferred to McCann b. $16.8 million of Trimor loans, which included:

i. $4.4 million in loans that were written off prior to April 13, 2014, which included $2,155,464 of loans that had been Cash Store direct loans that had been assigned to Trimor;
ii. $12.4 million of brokered loans that had not been written off that had been written in Trimor's name;

c. $799,114 in loans in the name of other TPL Lenders of which $292,021 were written off prior to April 13, 2014.

23 The brokered line of credit product was discontinued in Ontario as at February 12, 2014 and no TPL Brokered Loans were made in Ontario during the CCAA proceedings.

24 New TPL Brokered Loans were made by the Applicants outside Ontario after the Initial Order (pursuant to the Amended and Restated Initial Order and additional TPL Protections Order) until May 12, 2014 when the Applicants ceased the broker business. The Monitor understands that, during this time, TPL Brokered Loans totalling $5,911,141 were made in the name of Trimor, with no new TPL Brokered Loans made in the name of McCann.

25 As at May 31, 2014, TPL Brokered Loans in the following value were recorded in the Applicants' books and records.

a. McCann: $4,274,924 of which $242,614 have been written off;
b. Trimor: $13,288,913 of which $3,059,224 have been written off;
c. Other TPL: $649,060 of which $266,823 have been written off.

26 Trimor post-additional TPL Protection Order loans (*i.e.* loans made after the date of the additional TPL Protection Order and before the business broker ceased in the name of Trimor for which a declaration had been made that Trimor is the owner) totalled $2,520,540.

TPL Post-Filing Receipts

27 After the additional TPL Protection Order was issued, segregated accounts were opened to maintain the McCann Post-Filing Receipts and the Post-Filing Trimor Ontario Receipts. After the broker business ceased, the Post-Filing Trimor Non-Ontario Receipts were also deposited into the Trimor account for post-filing receipts.

28 The Monitor reported the following amounts in the segregated accounts as of May 6, 2014:

a. McCann Post-Filing Receipts of $699,558

b. Post-Filing Trimor Ontario Receipts of $690,380.

29 The balances in the segregated accounts as of May 27, 2014 were as follows:

a. McCann Post-Filing Receipts of $927,774
b. Post-Filing Trimor Ontario Receipts and Post-Filing Trimor Non-Ontario Receipts of $2,092,824.

30 The balances in the segregated accounts as of June 4, 2014 were as follows:

a. McCann Post-Filing Receipts of $1,236,053
b. Post-Filing Trimor Ontario Receipts and Post-Filing Trimor Non-Ontario Receipts of $2,686,089
c. Other TPL Lender Receipts of $175,788.

The Monitor's Position on the Reviewable Transactions

31 The cross motion by the DIP Lenders seeks a declaration that any designation of TPL Brokered Loans in the name of Trimor or McCann and any assignment of non-brokered loans to Trimor or McCann are preferences pursuant to the CCAA and/or provincial legislation.

32 The Monitor has advised the DIP Lenders that it is of the view that it is the Monitor who has standing to proceed with such a challenge using the provisions of the CCAA (absent an order equivalent to a *Bankruptcy and Insolvency Act* s. 38 Order authorizing the DIP Lenders to do so) and that, at this time, the Monitor is not bringing a preference or transfer at under value application. The Monitor advised that it continues to investigate relevant facts and is evaluating the merits of such an application, together with its assessment of other transactions made prior to the Initial Order.

33 The Monitor does not take a position on the DIP Lenders' motion pursuant to provincial reviewable transaction legislation.

34 McCann has requested that its legal and other professional fees incurred in or in connection with the CCAA proceeding be paid by the Applicants and be included in the Administration Charge. The Monitor notes that Trimor (which has not made a similar request for relief) does not have its legal or professional fees listed in the Administration Charge although Trimor's legal counsel (McMillan LLP) is listed in the Amended and Restated Initial Order among counsel whose reasonable fees and disbursements the Applicants "shall also be entitled to pay". The Monitor is of the understanding that this was included on the understanding that the Applicants would not fund any Trimor fees for challenges made by Trimor against the Applicants.

35 The Monitor notes that it is mindful of the limited resources available in the CCAA proceedings and that any party requesting coverage of fees pursuant to the Administration Charge

must establish that such coverage would be necessary for their effective participation in proceedings under s. 11.52 of the CCAA.

b. Submissions of TPLs

36 McCann and Trimor take the position that they entrusted millions of dollars to the Applicants for the sole purpose of brokering loans between the TPLs and Borrowers and at all times, the TPLs retained ownership of their funds and of all the loans ultimately brokered with those funds or otherwise purchased by or assigned to the TPLs. They also take the position that they own any accounts receivable in respect of their loans in any amounts actually received by the Applicants from their customers in repayment of the loan. The TPLs take the position that this arrangement was memorialized in written broker agreements.

37 The fundamental problem with this position, as I discuss in the next section, is that the written agreements did not accord with reality.

38 McCann requests a declaration that, among other things, McCann is the sole legal and beneficial owner of these funds, loans and receivables, as reflected in its broker agreement. Trimor takes the same position with respect to the funds it made available to the Applicants under its broker agreement.

39 The TPLs take issue with the position being taken by the DIP Lenders to declare that the TPLs' property belongs to the Applicants. The TPLs submit that the DIP Lenders do not articulate any plausible legal theory in support of their request but rather, they simply insist that the TPLs are mere unsecured creditors.

40 Further, the TPLs take issue with the DIP Lenders' preference arguments which they say are intended to attack ordinary course transactions between the Applicants and the TPLs. McCann submits that this issue is not properly before the Court as the right to impugn a transaction as a preference or transfer at undervalue belongs to the Monitor, and the Monitor has not challenged any of the transactions in question. The TPLs also take the position that the period for reviewing transactions as possible preferences has lapsed and, in any event, the evidence makes clear that the impugned transactions do not constitute preferences or transfers at undervalue. Rather, the TPLs take the position that TPL property is, and always has been, understood and intended to be, the property of the TPLs. They take the position that the transaction were not intended to prefer, defraud or otherwise hinder the Applicants' other creditors and the TPLs did not knowingly participate in any fraudulent scheme or preference.

The Broker Agreements

41 The position of the TPLs is founded on various broker agreements.

42 On June 18, 2012, McCann and Cash Store executed a broker agreement ("Broker

Agreement"). McCann takes the position that, as financier, it made $13,350,000 in funds available (the "McCann Funds") to Cash Store, as broker, for the sole purpose of Cash Store brokering loans (the "McCann Loans") between McCann and Cash Store's customers (the "Customers").

43 Before the McCann Funds could be loaned out, the Broker Agreement provided that Cash Store was required to ensure that extensive loan criteria were met or to obtain specific approval from McCann. Further, the McCann Funds were to be used for no other purpose. This requirement is set out in Article 2.10 of the Broker Agreement:

> 2.10 Usage of Loan Advances
>
> For greater certainty, funds, from time to time, advanced to broker from financier are solely intended to be utilized for the purposes of making advances to broker customers on financiers' behalf as contemplated hereunder. The broker agrees that any funds not otherwise being held by the broker as a "float" in anticipation of loan approvals shall not, without the consent of financier, be advanced or utilized for any other purpose.

Representations Allegedly Made to McCann

44 McCann contends that in discussions leading up to the Broker Agreement's execution, and while Cash Store was administering the McCann Funds on McCann's behalf, it was expressed to be important to McCann that its funds be kept separate and apart from Cash Store Financial's general operating funds in accordance with the Broker Agreement. McCann takes the position that Cash Store Financial assured it that the McCann Funds were - and could continue to be - segregated at all times. McCann alleges that Cash Store represented to McCann, and it was a term of the Broker Agreement, that all of the McCann Funds would be placed in a "designated broker bank account", which would be separate and apart from Cash Store Financial's general operating account.

45 McCann also takes the position that it understood McCann owned both the McCann Funds and the McCann Loans and that its accounts would be administered on a segregated basis from Cash Store's funds and be pooled safely with other "broker only" monies.

46 In his affidavit, Mr. Murray McCann, former president of McCann, states that a number of account statements were received from Cash Store and that the "funding excess/deficiency" on the statements provided a summary of the McCann Loans. Mr. McCann goes on to state that when the McCann Funds exceeded the amount deployed as loans to customers, Cash Store described the undeployed monies as the "funding excess/deficiency". McCann states that at all times he understood this amount to be held separate and apart from Cash Store's other accounts in accordance with the Broker Agreement and McCann's instructions. Further, he states that Cash Store's public disclosure always showed the McCann Funds as McCann's property, not the property of Cash Store or Cash Store Financial.

47 As recently as mid-March 2014, Mr. McCann states that Mr. Carlstrom, Vice President, Financial Reporting for Cash Store Financial, provided assurances to McCann that undeployed portions of the McCann Funds were secure and remained available to McCann and that Cash Store was administering McCann's property in accordance with the Broker Agreement.

Additional Submissions of McCann

48 McCann takes the position that under the Broker Agreement, McCann owned loans made in the name of TPLs which were brokered by Cash Store on behalf of the customers using funds made available by McCann. In addition, McCann takes the position that it also owned advances originated by Cash Store which were subsequently purchased with the McCann Funds, and certain loans and advances originated by Cash Store which were subsequently assigned to McCann as capital protection or otherwise. McCann takes the position that it was entitled to receive a stated rate of 59% interest under these loans from the customers.

49 McCann acknowledges that the McCann Loans were, by their nature, risky and accordingly, Cash Store historically made inducement payments to TPLs - referred to by Cash Store as "retention payments" - to induce TPLs to continue to make their funds available to Cash Store, which, in turn, enabled Cash Store to earn Broker Fees. In other words, these payments were intended to ensure that the TPLs were receiving a return commensurate with the considerable risk they were assuming. These "inducement payments" or "retention payments" were made by Cash Store on a monthly basis.

50 Until March 2014, McCann states that it received monthly statements indicating the cash that McCann had made available to Cash Store and the amount that was deployed in loans to customers.

51 In the Carlstrom affidavit, Mr. Carlstrom acknowledged that the so-called "restricted cash" in Cash Store's bank accounts totalled $12,961,000 as at February 28, 2014. However, by close of business on April 11, 2014, this amount had dwindled to approximately $2.9 million.

52 McCann takes issue with Cash Store's disclosure of events when they moved for the Initial Order. Specifically, McCann contends that Mr. Carlstrom did not disclose in his affidavit that, in breach of the Broker Agreement and without the knowledge or consent of McCann, and contrary to the multiple representations made to McCann, Cash Store had misappropriated the TPLs monies and spent them on the Applicants' operating and professional costs leading up to the CCAA filing.

53 McCann takes the position that the Special Committee must have made the decision to use the McCann Funds knowing that Cash Store and Cash Store Financial were acting in breach of the Broker Agreement and that they had misrepresented that McCann's monies had been properly segregated.

54 McCann states that it is undisputed that Cash Store received approximately $42 million of TPL monies to broker but, in the Monitor's pre-filing report, the Monitor reported that only $18.66

million of brokered loans were outstanding and that Cash Store had only $2.94 million cash on hand. Combined, these two figures equal $21.6 million, which results in the remaining $20.4 million being misappropriated.

Increased Risk Created by the May 13 Order

55 Subsequent to the granting of the Initial Order, McCann complains that the order of May 13, 2014 (the "May 13th Order") put the TPLs at further risk. The May 13th Order approved the cessation of the Applicants brokered loan business in all jurisdictions in which they operated that business. Also, the Chief Restructuring Officer (the "CRO"), in consultation with the Monitor, was authorized to take steps to conduct an orderly cessation of that business.

56 The TPLs contend that not only did they not agree to allow their monies and receivables to be held and used by an insolvent Cash Store, the May 13th Order puts the TPLs in even greater jeopardy as it purports to create charges against the TPLs' property and treat it as if it is the Applicants' property.

57 Paragraph 13 of the May 13th Order provides that the TPL charge is capped at $2.94 million and ranks third (*pari passu* the DIP Lenders) after the Administration Charge and the Director's Charge (up to a maximum of $1,250,000). They contend that this increases the risk that the costs of these proceedings would be paid out of the TPLs' remaining monies, after many millions of dollars of TPL Funds were already misappropriated by Cash Store for payment of costs not authorized by the TPLs leading up to the CCAA filing.

Trimor's Submissions

58 Counsel to Trimor supported the submissions of counsel to McCann, as applicable to Trimor.

59 Trimor transferred funds totalling $27,002,000 to Cash Store under the Broker Agreements for the sole purpose of brokering loans to customers (the "Trimor Funds").

60 Trimor is a party to the following broker agreements with Cash Store (the "Broker Agreements"):

a. Broker Agreement between Trimor and Cash Store dated February 1, 2012 and made as of June 5, 2012;
b. Broker Agreement between Trimor and 1693926 Alberta Ltd. dated September 24, 2012 and made as of June 5, 2012.

61 The Broker Agreements are similar (if not identical) to the broker agreements that Cash Store entered into with other TPLs, including McCann.

62 Trimor takes the position that when Trimor funds were deployed as loans to customers, the creditor or lender is Trimor and Cash Store takes a brokerage fee. The supporting agreements and

disclosure statements signed by customers named Trimor as the credit grantor and the customer as the borrower for the Trimor Loans.

63 Trimor contends that the TPLs, including Trimor, only made the TPL Funds available as a result of representations that the Funds were segregated, held in trust, and used only for a specific purpose.

64 Trimor contends that if the interest received by the TPLs was less than 17% of the TPL Funds, Cash Store would make a payment to bring cash received up to 17.5% (a "Retention Payment") and that Cash Store made the Retention Payments as an inducement to ensure that TPLs were receiving a return that was commensurate with the risk of lending.

65 In January 2012, Cash Store offered $132.5 million in Senior Secured Notes due in 2017 through a private placement (the "Secured Note Offering"). Cash Store's offering circular dated January 12, 2012 (the "Circular") for the Secured Note Offering advised potential investors that Cash Store "currently acts primarily as a broker of short-term advances between our customers and third party lenders, the effect of which is that the loan portfolio we service is not financed on our balance sheets".

66 These statements were repeated in financial statements. Trimor further contends that in its Circular, Cash Store advised potential purchasers of its bond that "we have made the decision to voluntarily make retention payments to the third party lenders as consideration for continuing to advance funds to our customers" and that "the decision has been made to voluntarily make retention payments to the Lenders to lessen the impact of loan losses experienced by the third party lenders".

67 Trimor further contends that the DIP Lenders/Bond Holders were well aware of this practice and took no issue with it. However, this statement, which was made at paragraph 27 of the Factum, is not referenced to the evidence in the record.

68 Similar to McCann, the Broker Agreements for Trimor provide that all funds advanced by Trimor were to be held in a designated broker bank account, which is a Cash Store bank account that is "designated by [Cash Store] for the purposes of temporarily receiving funds from [Trimor] ... before they are advanced to a [customer]". Trimor further contends that until January 2014 a separate bank account was used for the deposit of TPL Funds, including the Trimor receipts and the payment of Retention Funds.

69 Trimor also contends that it received assurances from Cash Store that it would treat the Trimor Funds as being held in trust for Trimor's benefit.

70 Trimor takes the position that since the CRO has determined, in consultation with the Monitor, that it is necessary and appropriate to implement a cessation of the brokered loan business and cease brokering new loans in all jurisdictions in which Cash Store operates, that Cash Store's intention to cease all brokered loan operations effectively terminates the Broker Agreements. In turn, Trimor

now has the option to allow the Applicants to continue to administer the Trimor Loans, transfer their administration to a new service provider, or sell the Trimor Loans to a third party.

71 Trimor contends that they will be seriously prejudiced if the Trimor Loans are not transferred to their control.

72 On this motion, Trimor asks the Court to confirm Trimor's ownership of the Trimor Loans and receipts and to allow Trimor or its agent to assume administration of the Trimor Loans to maximize realizations in accordance with Trimor's contractual rights.

c. Submissions of the DIP Lenders

73 Not surprisingly, the DIP Lenders, supported by the Ad Hoc Committee of Cash Store Noteholders (the "Committee") disagree with the position being taken by both McCann and Trimor. The TPLs base their claim upon the framework of the Broker Agreements. The DIP Lenders take the position that the TPLs' actual practices with Cash Store established that the TPSs varied the Broker Agreements, and in fact, entered into a debtor/creditor, or lending relationship with Cash Store. The focus of the inquiry is, in my view, whether the actual practices followed by the parties had the effect of varying the Broker Agreements.

74 The DIP Lenders point out that the TPLs received a fixed rate of return on funds provided to Cash Store and did not directly bear the collection risk of any individual customer loan made by Cash Store.

75 In addition, the DIP Lenders take the position that the funds advanced by the TPLs were comingled with Cash Store's general operating cash from which customer loans were made and there was no way to determine which funds belonged to the TPLs or which loans were made with funds advanced by the TPLs. The DIP Lenders take the position that it is uncontradicted that the funds were comingled and used from general operating accounts.

76 Simply put, the position of the DIP Lenders is that of the TPLs became creditors and consented to Cash Store having use of all funds received back from customers and they became, in fact, lenders to Cash Store. As a result, Cash Store continues to be entitled to all funds received back from customers. The DIP Lenders contend that the TPLs sought and received the benefit of gratuitous retention payments and capital protections paid by Cash Store and, in so doing, they avoided the risk of their putative broker relationship. They also became creditors. Consequently, the TPLs are not entitled to disavow that creditor relationship and return to the status of broker.

77 The DIP Lenders recognize that an understanding of the true nature of the relationship between Cash Store and the TPLs starts with the Broker Agreements. However, from their standpoint, it is necessary to review actual practice.

78 The DIP Lenders concede that had the TPLs chosen to strictly follow their Broker

Agreements, they could have had the benefit of specific fund recognition.

79 The Broker Agreements contain a section entitled "Loan Funding by Financier" that details the means by which the financier (the TPL) can provide the money used by Cash Store to make loans to customers. Those means include payments made:

a. By wire transfer of funds to the designated broker bank account (for redirection/payment to, or for the benefit of, the broker customer); and
b. By cheque drawn by financier payable to broker (Cash Store) for deposit to the designated broker bank account (for redirection/payment to, or for the benefit of the, the broker customer).

80 Further, the Broker Agreements go on to define "designated broker bank account" as:

> ... the bank account of broker designated by broker for the purposes of temporarily receiving funds from financier (if loans are made by financier way [sic] of cash advances) before they are advanced to a broker customer (...).

81 With respect to receipts, the Broker Agreements entitle the TPL to designate a bank account for receipt of funds directly from Cash Store customers:

> "Designated financier bank account" means, the bank branch and account designated by financier from time to time where (and into which) deposits of cash and cheques received from broker customers, in respect of such financier funded loans, are to be cleared (deposited) from time to time ..."

82 The Broker Agreements also grant the TPLs the opportunity to audit the records of Cash Store. The DIP Lenders take the position that the TPLs did not exercise those rights. Instead, they chose to accept variations to these agreements by which they benefited.

83 As detailed in their factum at paragraph 16, the DIP Lenders describe the basis on which the third party lending business of Cash Store actually functioned:

a. The TPLs provided Cash Store with initial tranches of funds;
b. The funds were lent to Cash Store customers, in the name of the TPL (in Trimor's case, but not McCann's);
c. Cash Store customers, if not in default, repaid the borrowed funds to Cash Store, together with interest of 59%;
d. Cash Store deposited the returned funds and interest to a general account;
e. Cash Store made voluntary payments to the TPLs from Cash Store general revenue, in order to ensure that the TPLs received a fixed 17.5% return;
f. Cash Store provided voluntary "capital protection" to the TPLs, insulating them for customer credit risk;

g. Cash Store made new loans to customers, from the general account, in the name of the TPL; and

h. Cash Store recorded a receivable for the TPL, with respect to the re-lent funds.

84 The DIP Lenders point out that Trimor and McCann were treated differently under the loan documentation. Specifically, when a customer took out a loan that was to be designated as being made on behalf of Trimor, the loan documentation explicitly stated that Trimor was the lender. When a customer took out a loan that was designated as being made on behalf of McCann, the documentation made no such specification. Rather, the loans listed another party as lender, and were then transferred into McCann's name.

85 The DIP Lenders also point out that each of the processes described above were accepted by the TPLs, with the disputed exception of the general account comingling.

86 The DIP Lenders recognize that on their surface the Broker Agreements contemplate a pass-through principal-broker arrangement. However, the practices adopted by the parties with regard to payments made by Cash Store to the TPLs reflected a different reality. The DIP Lenders reference Mr. McCann's email correspondence to Cash Store in which, from their standpoint, it was recognized that the TPLs, in substance, loaned funds to Cash Store and the TPLs were creditors of Cash Store. In an email dated March 14, 2014, Mr. J. Murray McCann stated to Mr. Gordon Reykdal as follows:

> Good morning Gord,
>
> I look forward to our call today and our visit in about a week.
>
> You mentioned that you were meeting with Steve and Craig this morning to discuss our loan to back stop Ontario payday loan customers and the requirements for funds in regulated provinces. We have attempted to redeploy the funds in Ontario since they are no longer being used to backstop payday loans there but so far with no success. Those funds are no longer secured by the payday creditors and the funds from those accounts collected were to be credited to us. It appears that those funds were credited to the account of Cash Store in contravention of our mutual understanding and agreement.
>
> Because the funds we have loaned are from a foundation it is even more important that we not place those funds at risk. As you know we went to considerable effort and legal cost to get the opinion and comfort that we required to assure that funds loaned to Cash Store were an ok investment because they

were secured by loans and the promise of Cash Store for proper accounting of those loans. Now that the loans that supported our loans were collected we must ask for repayment. Should Cash Store require further loans as backup to payday loans in regulated provinces and secure those loans with payday loans, as in the past, we will be happy to make funds available. We are happy with the return received from Cash Store and look forward to continuing our relationship for a very long time.

Please be assured that the interest Cash Store is paying us is going to very worthwhile causes that rely on our funding. We can never let them down. That is the main reason that we make sure that any agreements we enter into on their behalf is never at risk. On the other hand we will always live up to our side of the agreement.

I look forward to our call later today.

Cheers,

Murray

87 On April 12, 2014, Mr. J. Murray McCann sent another email to Mr. Reykdal as follows:

Good afternoon Gord,

I have attempted to contact you on numerous occasions and have left messages on your cell, office phone with Sandy. Attempting to keep a creditor and friend in the dark by ceasing all communication is neither the way to treat a friend nor a creditor. As mentioned to you, on more than one occasion, the funds Rent Cash is improperly holding are used to support a large school, orphanage and girls residence in Zambia. Without those funds teachers, caregivers, food suppliers etc. cannot be paid and our school of 400 students will have to close. I told you this before and you assured me that Rent Cash was looking after our money diligently and there was no need to worry.

Please Gord do what you know is right and release our funds so that they can continue to be used for the good purposes they have been used for. You know that the money is not Rent Cash's and have stated that on many occasions and

even as late as 2 weeks ago when we visited at your club and your home in Scottsdale. You, as president, promised and assured that all was well and our funds were being held by Rent Cash for our benefit.

Please contact me.

Sincerely,

Murray

88 The DIP Lenders contend that, in reality, the TPLs were effectively guaranteed a rate of return of 17.5% of the advances (though it appears that Trimor earned interest at a rate of 20% prior to May 2011). Further, notwithstanding the actual fluctuations of payments of interest and principle seen by Cash Store's customers, the monthly reconciliations and interest schedule forwarded by Cash Store to each TPL calculate a simple return of 17.5% on the total principal advanced by each TPL.

89 In order to make this guarantee possible, the DIP Lenders contend that Cash Store made "retention payments" each month. The retention payments effectively made up any shortfall between actual amounts recovered from customers and the 17.5% interest owed to the TPLs. They reference comments of Ms. Erin Armstrong, former Chief Operating Officer of Trimor who stated that these retention payments were in fact a "top up" to make sure Trimor received its expected interest payment each month.

90 Up to April 2014, Cash Store's retention payments or "top up" ensured that McCann received total interest payments of $3,353,696.92 and Trimor received total interest payments of $7,839,676.14.

91 The DIP Lenders also argued that in addition to compensating the TPLs with routine retention payments, Cash Store indemnified the TPLs for customer loan losses through use of a capital protection scheme to help the TPLs maintain the broad principal behind their loan portfolios. They contend that that scheme had two components:

a. An expensing mechanism, whereby Cash Store would credit the TPLs with a book entry in the amount of any losses suffered by the TPLs on brokered loans that remain unpaid after 90 days. This protected the TPLs' advances of principal from being eroded by bad loans; and
b. A purchasing mechanism (in Ontario and Manitoba), whereby Cash Store purchased past-due brokered loan fees at face value from the TPLs.

92 As referenced in the PwC Report, in the summary of Trimor's holdings, the lines of credit assigned to Trimor were broken up by length outstanding, and with zero percent of Trimor's loans having been held for longer than 90 days. As such, the DIP Lenders contend that Cash Store had acquired all of Trimor's bad debt, insulating it completely from the credit risk of the PayDay lending products. The DIP Lenders contend that instead, the TPLs took on the risk of Cash Store's insolvency, and the concomitant effect on these gratuitous mechanisms.

93 According to the DIP Lenders the simple fact is that in each and every month of the TPLs' relationship with Cash Store, each TPL earned its constant rate of return and experienced little or no erosion of its "restricted cash". In so doing, they converted their Broker Agreements into lending agreements.

94 Further, the DIP Lenders point out that it was always Cash Store's practice to hold funds related to third party lending activities in its own corporate accounts, comingled with all of its other cash. The DIP Lenders note that this practice was, in Cash Store's view, well known to the TPLs and fully disclosed to the Court on the CCAA filing. The DIP Lenders point out that the TPLs first claimed to believe that the funds were held in accounts designated to be used solely to receive each individual TPL's advances as set out in the Broker Agreements - notwithstanding that the TPLs were aware of and benefited from other "extra contractual" arrangements. The DIP Lenders point out that that evidence varied somewhat under cross-examination and in light of contemporaneous documentary evidence.

95 For example, in her affidavit, Ms. Fawcett stated that a segregated bank account was represented to be in use:

> As indicated in my prior Affidavit, it was represented to me and Mr. McCann at the time the Broker Agreement was entered into, and it is a term of the Broker Agreement, that all Restricted Cash would be placed in a Designated Broker Bank Account, which would be separate and apart from Cash Store Financial's general operating account.

96 However, as pointed out by the DIP Lenders, Ms. Fawcett was aware that McCann Funds had been comingled with other funds. They referenced an email sent by Ms. Fawcett to Mr. Michael Zvonkovic, former CFO of Cash Store on July 19, 2012 where Ms. Fawcett asked whether McCann's Funds were actually maintained in an individual segregated account:

> On the Broker Agreement funds, so you keep a separate "designated broker bank account" for each financier such that all of the loans made using our funds are paid from and returned to that account, as well as all related interest and fees?

97 In response, Mr. Zvonkovic stated:

> In the new agreement, we've tried to combine all these accounts and not to have a

> designated broker bank account. Your funds specifically would be tracked separately via our accounting system.

98 The DIP Lenders point out that Ms. Fawcett, on cross-examination, stated that it was always her understanding that the designated broker bank account was to be used to hold the funds provided by or received by all TPLs, and not merely those related to McCann.

99 The DIP Lenders point out that Trimor, for its part, asserted that it was assured its funds would be held in trust:

> ... [Cash Store] consistently assured Trimor that Trimor's funds were not used for any purpose other than advancing loans in accordance with the Broker Agreement. In addition [Cash Store] assured Trimor that it would treat the Trimor funds as being held in trust for Trimor's benefit.

100 On cross-examination, Ms. Armstrong stated that:

a. This statement was made regarding an earlier form of broker agreement which did contain trust language; and
b. The current Broker Agreement contained no such trust language whatsoever.

Restricted Cash and Assigned Loans

101 The DIP Lenders also contend that a review of the monthly reconciliation process undertaken by Cash Store for the benefit of the TPLs suggested that the funds advanced by the TPLs were not segregated from Cash Store's general funds.

102 The affidavit of Mr. Carlstrom points out that if the overall cash balance in Cash Store accounts fell below the recorded balance of theoretical restricted cash, Cash Store would assign its non-brokered loans to the TPLs to offset this deficiency. When made, these offsets were set out in each of the monthly reconciliations provided by Cash Store, and were distinguished from purchases of loan portfolios or other loans designated to the TPLs.

103 Accordingly, from the standpoint of the DIP Lenders, the TPLs understood or ought to have understood that Cash Store would sometimes assign receivables for the benefit of the TPL rather than use TPL advances to actually make or purchase customer loans.

IV. Analysis

The Preference Issue and Cash Store's Insolvency

Cash Store's Insolvency

104 The DIP Lenders contend that based upon book values, the value of Cash Store's liabilities exceeded the value of Cash Store's assets as at September 30, 2013 and the insolvency became increasingly severe and by December 31, 2013, Cash Store's liabilities exceeded assets on a book value basis by over $8 million.

105 The DIP Lenders raise the issue of whether the designation or assignment of loans in the name of the TPLs was a preference.

106 In my view, these issues are not properly before the court at this time. The issue properly before the court is the question of ownership of the funds advanced by the TPLs.

107 In arriving at this conclusion, I am in agreement with the submissions put forth by counsel to McCann.

108 Under ss. 95 and 96 of the *Bankruptcy and Insolvency Act* ("BIA"), a trustee in bankruptcy has the right to challenge a payment or transaction as a preference or transfer under value. Section 36.1 of the CCAA extends this right to a CCAA monitor. It does not extend it to individual creditors of the CCAA debtor.

109 At this point, the Monitor is currently reviewing transactions involving the TPLs. The Monitor has not reported its findings in this regard. The right of the Monitor to challenge these transactions has not been the subject of any assignment to a specific creditor of the type contemplated by s. 38 of the BIA.

110 In the absence of some form of assignment of the Monitor's rights, which has yet to take place, I have reached the conclusion that the DIP Lenders are not in a position to challenge transactions as preferences or transfers at under value pursuant to the provisions of the CCAA.

111 With respect to the potential challenge under the *Fraudulent Conveyances Act*, or *Assignments and Preferences Act*, there is a degree overlap with respect to the statutory test and the remedies provided by these statutes and the use of the preference and transfer at undervalue provisions of the BIA and the CCAA.

112 With respect to challenges under the *Assignments and Preferences Act*, an inquiry has to be undertaken as to whether or not the debtor was insolvent at the time of the transaction. The specific date of insolvency of Cash Store has not, in my view, been fully explored in the record. Rather, the record has focussed on the nature of the relationship between the TPLs and Cash Store which will be the subject of further discussion below. It seems to me that if the DIP Lenders wish to pursue the issue of whether certain transactions were preferential in nature, a formal trial of the issue will have to be directed on this point.

113 Similarly, in considering whether a designation or assignment of loans in the names of the TPLs were fraudulent conveyances, the focus of the inquiry has to be on the intention of the parties.

I am not satisfied that the record before me would enable such an inquiry to be undertaken. Again, it would seem more appropriate to address this issue through the direction of a formal trial of the issue.

114 In summary, the Monitor can report further with respect to its inquiries on this issue and the DIP Lenders shall have the opportunity to revisit the issues arising out of the *Assignments and Preferences Act* and the *Fraudulent Conveyances Act* at a future date.

115 The cross-motion of the DIP Lenders is accordingly dismissed, without prejudice for the DIP Lenders to renew their motion taking into account the foregoing comments.

Status of and Funds Advanced by McCann/Trimor

116 Both McCann and Trimor made significant amounts of money available to the Applicants. The Broker Agreements expressly provides that McCann and Trimor own the funds, loans and receivables. McCann and Trimor requested declarations in respect of the funds each made available to the Applicants, that McCann and Trimor are the legal and beneficial owners of these funds, loans and receivables, as reflected in the Broker Agreements.

117 The DIP Lenders take the position that the TPLs do not have a proprietary right to the funds, but rather, the TPLs are creditors of Cash Store.

118 In order to determine the issue, it is necessary to examine the relationship as originally set out in the Broker Agreements and to trace the relationship between the Applicants and the TPLs subsequent to the execution of the Broker Agreements.

119 The Broker Agreements expressly recognize that ownership of TPL property was intended to remain with the TPLs.

120 The TPLs advanced funds to Cash Store for the purpose of enabling Cash Store to broker loans to its customers. At the outset, the TPLs understood that their funds were segregated from Cash Store's operating funds. This was provided for in the Broker Agreements and was confirmed in certain representations made by Cash Store and Cash Store Financial that TPL Funds would be maintained in a designated TPL account.

121 The TPLs take the position that even if the Funds had been co-mingled with Cash Store's operating funds in breach of the Broker Agreement and without their knowledge, the TPL Funds have always been accounted for separately. Further, they take the position that Cash Store's creditors could always discern the amount of the TPL Funds that were deployed as loans to customers or held as a float for future loans.

122 However, in practice, the Funds were not segregated from Cash Store's operating funds. The funds were co-mingled with Cash Store's operating funds. The TPLs may disagree based on the

documents and what they were led to believe, but the TPLs' internal knowledge and belief does not determine the issue. Rather, the determining fact is that the Funds were co-mingled with Cash Store funds in the operating account. As such, regardless of what the TPLs believed, there was one account and it is not possible to identify the source of the funds.

123 It is also necessary to look at the basis upon which the relationship between the TPLs and Cash Store developed. Pursuant to the Broker Agreements, the TPLs would provide funding to Cash Store and Cash Store would broker loans to its customers. The customers would pay a rate of interest of 59%. The interest payments were to flow through to the TPLs. However, in reality, this did not happen. By their nature, the type and quality of the loans made to Cash Store customers would be characterized as high-risk loans. There was a significant default rate. The practice developed that Cash Store would effectively provide a rate of return equivalent to 17.5% per annum to the TPLs and Cash Store made "voluntary payments" to the TPLs in this amount.

124 It is also clear that the TPLs were aware that they were receiving this 17.5% payment. Indeed, such a payment was expected. The TPLs received monthly payments at a 17.5% rate of return and regardless of the status of the brokered loans obtained by Cash Store, the TPLs received their 17.5% and were insulated from any credit risk as a result of the capital protections used by Cash Store.

125 During the period of time that Cash Store was making these payments of 17.5% to the TPLs, there is no evidence of any complaint being made by the TPLs to Cash Store. Rather, these payments were accepted by the TPLs and for all intents and purposes, gave the appearance of an "ordinary course" payment. There is no evidence that the TPLs ever took steps to challenge why interest at 59% was not being received. To state the obvious, this interest rate differential of 41.5% (less an amount to be written off as bad loans) is significant. It raises a question for which there is no recorded explanation, namely why were the TPLs apparently content to receive a return of 17.5%, when customers of Cash Store, borrowing funds supposedly belonging to the TPLs, were paying 59% interest, in addition to Cash Store's brokerage fee. The inescapable conclusion is that the relationship as between the TPLs and Cash Store was such that the 59% interest payments were never expected to flow through to the TPLs. It also raises another question, namely whether the operations of Cash Store complied with payday loan regulations generally. I note, however, that this question is not before me on this motion.

126 From the standpoint of the DIP Lenders, this ongoing payment equivalent to 17.5% of outstanding amounts is significant and leads me to a finding that the relationship between the TPLs and Cash Store was debtor-creditor relationship and that the payments which are equivalent to 17.5% of outstanding funding reflect a payment of interest. A payment of interest is clearly inconsistent with the position being put forth by the TPLs, namely that there was no debtor-creditor relationship.

127 In this case, I have reached the conclusions that the parties did alter the relationship from

what was set out in the Broker Agreements. I am satisfied that the evidence establishes that, in practice, the TPL business of Cash Store involved:

a. making of loans by Cash Store to retail customers that were either designated as being made on behalf of a TPL or assigned to a TPL (see references at footnote 59 of DIP Lenders Factum);
b. receipt of repaid retail loans and interest back into Cash Store's general accounts (see references at footnote 60); and
c. Cash Store paying the TPLs a guaranteed interest rate of 17.5% (see references at footnote 61).

128 The presence of an "entire agreement" clause in the Broker Agreement does not assist the TPLs. The "entire agreement" clause has application with respect to various arrangements and agreements entered into by parties up to the time of entering into an agreement with such a clause. However, it does not follow that the parties cannot modify their arrangements subsequent to the execution of the Broker Agreement.

129 As noted in the submissions of counsel to the DIP Lenders, notwithstanding the presence of a "non-waiver" clause in the contract, parties can still waive their contractual rights by election. Specific reference was made to *Barkley's Bank PLC* v. *Devonshire Trust (Trustee of)*, 2011 ONSC 5008, where Newbould J. explained the presence of an non-waiver clause is "not the end of the matter", going on to quote Swinton J.'s reasons in *Fitkid (York) Inc.* v. *1277633 Ontario Limited* [2002] O.J. No. 3959 (SCJ) as follows:

> Even where there is a term in the lease governing waiver, the cases on waiver indicate that courts look at the conduct of the landlord to determine whether it has elected not to terminate the lease in the circumstances after the right of forfeiture arises.

V. <u>Disposition</u>

130 I conclude that the relationship as between the TPLs and Cash Store is one of debtor and creditor.

131 The consequences of this finding is that the motion of the TPLs is dismissed. The TPLs are creditors of Cash Store.

132 An order shall issue that the Applicants are the beneficial owners of funds described as the Disputed Post-Filing Receipts in the TPL Notices of Motion and neither Trimor nor McCann shall take any steps to collect any advances or loans made to the Applicants' customers, irrespective of whether such loans or advances have been designated in the name of Trimor or McCann or otherwise assigned to Trimor or McCann by the Applicants, and any recoveries or collections on such advances or loans by Trimor or McCann shall be deemed to be held in trust for the Applicants.

133 With respect to McCann's request that its professional fees in connection with the CCAA proceeding be paid by the Applicants and be included in the Administration Charge, the treatment accorded to Trimor outlined in [34] should also be provided to McCann.

G.B. MORAWETZ J.

TAB 3

Case Name:

Tucker v. Aero Inventory (UK) Ltd.

APPLICATION UNDER Section 46 and following of the Companies' Creditors Arrangement Act, R.S.C. 1985, c. C-36, as amended
IN THE MATTER OF the Companies' Creditors Arrangement Act, R.S.C. 1985, c. C-36, as amended
AND IN THE MATTER OF James Robert Tucker, Richard Heis and Allan Watson Graham of KPMG LLP, as Joint Administrators, Applicants
AND IN THE MATTER OF Aero Inventory (UK) Limited and Aero Inventory PLC, Respondents

[2011] O.J. No. 3816

2011 ONSC 4223

80 C.B.R. (5th) 1

2011 CarswellOnt 8476

338 D.L.R. (4th) 577

206 A.C.W.S. (3d) 466

Court File No. 09-8456-00CL

Ontario Superior Court of Justice
Commercial List

G.B. Morawetz J.

August 18, 2011.

(169 paras.)

Bankruptcy and insolvency law -- Proceedings -- Practice and procedure -- Setting aside transactions prior to bankruptcy -- Fraudulent preferences, conveyances or transactions -- Preliminary determination of question of law -- Trustee commenced preference action to declare transactions void and for return of preference proceeds -- Preliminary issue arose as to whether

Trustee could prosecute action on behalf of secured creditor and whether proceeds would be distributed to secured creditors or unsecured creditors -- Court declared that Trustee was only party who could bring preference action and any recovery was brought into estate for distribution, subject to rights of secured creditors dependent on factual scenario and rights in collateral at time of impugned transactions -- Bankruptcy and Insolvency Act, ss. 95, 136.

Preliminary determination of question of law on a motion by the Trustee in Bankruptcy for Aero Inventory to have transactions between Aero and Air Canada declared void and for return of the preference proceeds. The transactions arose from an agreement under which Aero was Air Canada's exclusive supplier for inventory used for line maintenance. Aero sold Air Canada a pool of inventory from which it was expected to purchase parts. Air Canada provided Aero with Bills of Exchange drawn on Air Canada. Air Canada subsequently alleged Aero failed to comply with the inventory purchase agreement. They reached an agreement whereby certain Bills of Exchange were delivered back by Aero to Air Canada. That delivery was the series of transactions challenged by the Trustee. The Trustee advised that secured creditors would suffer a significant shortfall and that there would be no funds available for distribution to unsecured creditors. The Trustee brought a motion seeking a declaration that the transactions at issue constituted a preference within the meaning of s. 95 of the Bankruptcy and Insolvency Act. A preliminary issue arose regarding the rights of creditors to the preference proceeds. The Trustee submitted that the proceeds, once recovered, would be subject to the rights of Aero's secured creditors. Air Canada took the position that the Trustee was not able to pursue a preference claim for the sole benefit of the secured creditors. Air Canada submitted that any proceeds should only benefit unsecured creditors.

HELD: Declaration ordered. The Trustee was the only party that could bring a preference action in bankruptcy proceedings. Any proceeds recovered were brought into the estate and distribution under the Bankruptcy and Insolvency Act was subject to the rights of recovery of secured creditors. The fact that a fraudulent preference action had commenced, did not preclude the ability of a secured creditor to realize on security or to follow the proceeds from security in accordance with the specific security agreement. The outcome was dependent on the factual scenario and whether a secured creditor had rights in the collateral at the time of the impugned transaction. If the transaction was out of the ordinary course of business or, if the recipient was on notice that it was an improper transaction, the secured party possibly had rights to recover the collateral or proceeds. However, if the debtor was in a position to lawfully dispose of the collateral free and clear of the security interest, and had done so, it was possible that the only recovery for the secured creditor would be to participate in a distribution to unsecured creditors under s. 136 of the BIA. Given that no compromise or arrangement had been proposed under the CCAA, the preference action should proceed under the BIA.

Statutes, Regulations and Rules Cited:

Bankruptcy and Insolvency Act, R.S.C. 1985, c. B-3, s. 13.4, s. 38, s. 67, s. 69.3, s. 70(1), s. 71, s.

95, s. 95(1), s. 96, s. 136, s. 136(1), s. 136(1)(f), s. 141

Companies' Creditors Arrangement Act, R.S.C. 1985, c. C-36, s. 11.7, s. 36.1, s. 36.1(1), s. 42, s. 46

Counsel:

Orestes Pasparakis, Evan Cobb and Vasuda Sinha, for the Trustee.

Sean F. Dunphy, Alexander D. Rose and Kathryn Esaw, for Air Canada.

John Porter, for Lloyds TSB Commercial Finance Limited.

ENDORSEMENT

1 **G.B. MORAWETZ J.**:-- KPMG Inc., as Trustee in Bankruptcy (the "Trustee") for Aero Inventory (UK) Limited and Aero Inventory plc (together, "Aero") brings this motion to have certain transactions (the "October Transactions") entered into between Aero and Air Canada declared void pursuant to s. 95 of the *Bankruptcy and Insolvency Act*, R.S.C. 1985, c. B-3, ("*BIA*"). The Trustee seeks the return of value in the amount of U.S. $75 million from Air Canada (the "Preference Proceeds").

2 A threshold issue has been identified. The Trustee takes the position that the Preference Proceeds, once recovered, would be subject to the rights of Aero's secured creditors. Air Canada takes the position that any proceeds resulting from this preference motion should only benefit Aero's unsecured creditors.

3 Therefore, at this point, the central issue is a question of law: are the proceeds of a preference action under s. 95 of the *BIA* subject to the rights of secured creditors?

4 In addition to the direction sought with respect to the priority of the Preference Proceeds, Air Canada also seeks an order regularizing the proceedings under the *Companies' Creditors Arrangement Act*, R.S.C. 1985, c. C-36, ("*CCAA*"), the parallel proceedings under the *BIA* and the preference motion.

BACKGROUND INFORMATION

5 In its factum, Air Canada has provided an account of the events leading up to the October Transactions. In view of the threshold question of law, in my view, it is premature to focus on the facts in respect of the October Transactions. A brief overview of the background is, however, helpful, to put matters into context.

6 On November 11, 2009, Administration proceedings in respect of Aero were commenced in the High Court of Justice of England and Wales (Chancery Division, Companies Court) (the "Foreign Proceedings"). Messrs. Tucker, Heis and Graham of KPMG LLP were appointed as joint administrators (the "Administrators") of Aero.

7 On the same day, this court recognized the appointment of the Administrators as foreign representatives of Aero (the "Foreign Representatives") under Part IV of the *CCAA*.

8 Aero reported that its secured creditors would face a shortfall of approximately GBP 150 million, while its unsecured creditors, who are owed approximately GBP 60 million, would receive virtually nothing at all.

9 Following the November 11, 2009 filings, the Foreign Representatives met with Air Canada and discussed, *inter alia*, the October Transactions. From the Foreign Representatives' standpoint, a concern arose that the October Transactions might constitute an unlawful preference.

10 The October Transactions arose out of a relationship between Air Canada and Aero in respect of maintenance required for Air Canada's aircraft. In December 2008 Air Canada and Aero executed an agreement (the "Line Maintenance Agreement") under which Aero became Air Canada's exclusive supplier for practically all of its Category 3 Inventory used for line maintenance.

11 In early 2009, Aero and Air Canada entered into an agreement (the "January Purchase Agreement") under which Aero sold to Air Canada a pool of Category 3 Inventory. Over the course of the year, Aero was expected to purchase parts from this pool of inventory.

12 In return, Air Canada provided Aero with nine U.S. $10 million principal Bills of Exchange (#1 - 9) and one similar Bill of Exchange (#10) for approximately U.S. $10.7 million (collectively, the "Bills of Exchange"). Each of the Bills of Exchange was payable to Aero and drawn on Air Canada. Air Canada contends that with the exception of transfers of the Bills of Exchange to Deutche Forfait (which never, in fact, occurred), the January Purchase Agreement required Air Canada's consent to any transfer of the Bills of Exchange.

13 Air Canada contends that Aero ultimately failed to comply with the most significant provisions of the January Purchase Agreement. Ultimately, Aero and Air Canada reached an agreement under which certain Bills of Exchange were delivered back by Aero to Air Canada. It is this series of transactions as between Aero and Air Canada that the Trustee refers to as the October Transactions.

14 In January 2010, the Foreign Representatives brought a motion to assign the Aero companies into bankruptcy expressly "for the purpose of pursuing a preference action under s. 95(1) or 96(1) of the *BIA*. On January 22, 2010, the court authorized the Administrators to assign Aero into bankruptcy and temporarily lifted the stay for that purpose (the January 2010 "Order").

15 In seeking the January 22, 2010 Order, the Administrators advised the court that they wished to assign Aero into bankruptcy to preserve the right to pursue any reviewable preferences that may have taken place during the statutory review period prescribed by the *BIA*. The Administrators further advised that their security searches had revealed two secured creditors, Lloyds (asserting a general security interest in Aero's assets) and Air Canada.

16 On February 4, 2010, the Trustee reported that although no claims process had been conducted, all creditors had been advised of the Administrators' view that the secured creditors would suffer a significant shortfall and that there would be no funds available for distribution to unsecured creditors. The Trustee further reported its expectation that the secured creditors' security would extend to any funds generated from a preference claim under ss. 95 or 96 of the *BIA*.

17 The Trustee also reported that, in light of the expectation that there would be no recoveries to unsecured creditors, it saw no value in incurring the expense associated with the discharge of its statutory obligations under the *BIA*.

18 On February 4, 2010, the Trustee filed a motion seeking to dispense with certain obligations of the Trustee under the *BIA*. The court granted the order sought by the Trustee (the "February 2010 Order"). Air Canada did not oppose the relief sought. The court issued the February 2010 Order in the *CCAA* proceedings extending the time period for the Trustee to perform its statutory obligations under the *BIA* (including convening a meeting of creditors and holding a vote of the unsecured creditors) until further order. The February 2010 Order further authorized the Administrators to provide direction to, and supervise the Trustee in pursuing the contemplated preference motion, subject to the review of the court.

19 On April 27, 2010, the Trustee brought a motion in the *CCAA* proceedings seeking a declaration that the October Transactions between Air Canada and Aero constituted a preference within the meaning of s. 95(1) of the *BIA*.

20 On June 30, 2010, the Trustee filed a report which included opinions from independent counsel on the validity and enforceability of the security held by a syndicate of secured lenders (the "Lenders") over Aero's assets.

21 Aero financed its business with the U.S. $500 million revolving facility which it obtained from the Lenders. The Lenders hold:

(a) a general security interest and fixed mortgage over all the personal property of Aero in Canada, which has been duly registered; and
(b) a deed of Hypothec also duly registered in the Province of Quebec.

THE ISSUES

22 Three issues need to be determined on this threshold motion:

(a) Whether secured creditors are entitled to assert priority over the proceeds of a preference action. Put another way, can the Trustee pursue the preference action solely on behalf of, and for the benefit of, a secured creditor?

(b) Is the preference motion properly brought within the *CCAA* proceedings, or should it be reconstituted in the bankruptcy proceedings?

(c) Should the February 2010 Order be varied to provide that the Trustee has to comply with certain obligations under the *BIA*?

23 As the Trustee points out in its factum, on several occasions, Canadian courts have had to consider whether a secured creditor has the right to assert its priority claim over the proceeds of a preference action. The Trustee acknowledges the body of jurisprudence appears unclear, inconsistent and conflicting.

24 It is the Trustee's position that jurisprudence and policy considerations underlying the *BIA* lead to the conclusion that the Preference Proceeds should be paid over to the Lenders by the Trustee.

25 Air Canada, not surprisingly, takes a different position. Air Canada does not contest the Trustee's ability to pursue preference claims in the bankruptcy proceedings. However, Air Canada takes the position that the Trustee cannot pursue a preference claim as an advocate for Lloyds or for Lloyd's exclusive benefit.

THE PARTIES' POSITIONS

1. Are secured creditors entitled to assert priority over the proceeds of a preference action and can the Trustee pursue a preference action solely on behalf of, and for the benefit of, a secured creditor?

Air Canada's Position

26 Air Canada takes the position that a trustee cannot pursue a preference action where the proceeds would accrue to the sole benefit of a secured creditor as to do so is inconsistent with the jurisprudence holding that fraudulent preferences that do not benefit unsecured creditors cannot be pursued. Instead, the right to pursue a fraudulent preference action is a statutory right of the trustee only, and where appropriate to pursue, such preferences are only void as against the trustee, such that the recovered property accrues to the benefit of the general body of unsecured creditors. Finally, Air Canada submits that the proposed preference action is inconsistent with the role of a trustee.

The purpose of a preference action

27 Air Canada submits that the purpose of a preference action is to allow for the equal distribution of the debtor's assets among the general body of creditors such that a trustee cannot pursue a preference action for the sole benefit of a secured creditor.

28 Further, the purpose of s. 95 of the *BIA* is to ensure that the debtor's money is divisible equally among unsecured creditors, subject to the priorities in s. 136 of the *BIA*. In support of this proposition, counsel to Air Canada cites the Supreme Court of Canada in *Hudson v. Benallack,* [1976] 2 S.C.R. 168 at p. 175, where it is noted that the purpose of preference actions is to put all creditors on an equal footing.

29 Counsel further submits that s. 95 of the *BIA* permits a trustee to challenge the debtor's transactions occurring on the eve of bankruptcy, as such transactions reduce the money available for distribution to creditors and presumably fail to treat all of the creditors equally. Conversely, where there would be no benefit to unsecured creditors from the pursuit of a preference action, the Trustee may not undertake a preference action.

30 In this case, the Trustee's position is that the proceeds of the preference action accrue to the benefit of the secured creditor. Counsel to Air Canada submits that this would not constitute a benefit to the general body of creditors such that this action cannot be pursued. Instead, secured creditors' rights are to be exercised outside of bankruptcy as a function of their security agreement and provincial law: *BIA,* ss. 69.3, 70(1), 136(1) and 141.

31 Air Canada takes the position that the jurisprudence is replete with examples of the courts declining to allow a trustee to pursue a preference action where the proceeds would accrue to the sole benefit of secured creditors.

32 Air Canada submits that in *Ex parte Cooper* (1875), L.R. 10 Ch. App 510 (Div. Ct.) at p. 511-512, the court found that the trustee ought not to pursue a preference action for the benefit of a single creditor. Instead, preference actions are to be pursued for the benefit of all creditors. In that case, a creditor alleged that he had given the debtor an advance of GBP 2000, secured by a consignment of the debtor's shipment of currants. However, once the shipment arrived, the debtor pledged the bills of lading for that shipment to a subsequent creditor, as security for advances made by that person. The Registrar declined to order the trustee to account to the estate for the value of the currants or take the necessary steps for their recovery, but did order that the first creditor was at liberty to use the trustee's name in any proceeding against the subsequent creditor or the debtor to enforce the delivery of the currants or payment of the proceeds to him. On appeal, the Divisional Court found that the trustee's name could not be used in a preference action by an encumbrancer, unless the secured creditor were to give up the claim on the property for the benefit of all creditors. There could be no fraudulent preference where the preference granted concerned property that did not belong to the bankrupt.

The right to bring a preference action is a statutory right of the Trustee

33 Air Canada takes the position that the Trustee's proposed preference action is incompatible with the fact that the right to pursue a preference action is a statutory right provided solely to the Trustee and a secured creditor cannot take advantage of the Trustee's statutory right. Instead, property recovered as a result of the exercise of the Trustee's statutory right is not subject to any security interest.

34 Counsel to Air Canada referenced *In Re Yagerphone Limited,* [1935] 1 Ch. 392 (Ch.D.) at p. 396, which counsel submits affirms the principle established in *Ex parte Cooper.* In *Re Yagerphone*, the liquidator sought to attack the provision of certain funds to a creditor, which funds were said to be subject to a debenture. The debenture holder was found to not be entitled to the proceeds of the preference action as he held a general or floating security interest in the debtor's property, rather than a fixed charge over those funds. As a result, the preference action could be pursued and the transfer was considered to be void solely as against the liquidator, with the recovered funds impressed with a trust in favour of the creditors generally.

Bennett J. stated at pp. 395-96:

> There have been two cases which establish quite clearly that, whether in bankruptcy or in the liquidation of a company, a secured creditor has no right to enforce for his benefit the remedy which is given to a trustee in bankruptcy or the liquidator of the company of avoiding a payment or setting aside a transaction made or entered into with a view to preferring a creditor of the bankrupt or a company in liquidation. The authorities are Ex parte Cooper and Willmott v. London Celluloid Co.
>
> Neither of these cases, as I have said, decides the point which arises on the summons. I propose to decide it in favour of the liquidators on this ground - namely, that, at the time when the securities contained in the debenture issued to H. Yager (London), Ld., crystallised, the 240l. 11s. 2d. was not the property of Yagerphone, Ld., the company which issued the debenture.
>
> ...
>
> The right to recover a sum of money from a creditor who has been preferred is conferred for the purpose of benefitting the general body of creditors, and I think Mr. Montgomery White was right when he said that the sum of money, when recovered by the liquidators by virtue of s. 265 of the Companies Act, 1929, and s. 44 of the Bankruptcy Act, 1914, did not become part of the general assets of Yagerphone, Ld., but was a sum of money received by the liquidators impressed in their hands with a trust for those creditors amongst whom they had to

> distribute the assets of the company. [Emphasis added; Citations omitted.]

35 Air Canada submits that the reasoning of *Re Yagerphone* was adopted in *Re Maybank Foods Inc.* (1990), 72 O.R. (2d) 93 (S.C.), and *Re Oasis Merchandising Ltd.,* [1998] Ch. 170 (C.A.). In *Re Maybank,* the respondent had conceded that the proceeds of a preference action are held in trust for the general body of creditors. Air Canada frames the distinction drawn in *Re Oasis* as between assets which were the debtor's property upon liquidation and may be subject to a charge, and those that were conveyed away to another creditor but recovered pursuant to a preference action, which are not subject to a charge. In other words, the court in *Re Oasis* drew a distinction between assets over which a secured creditor possesses a fixed charge at the time of liquidation, which are subject to the security, and assets which were conveyed to another creditor and recovered pursuant to a preference action, which were subject to a floating charge and, as such, not subject to the secured creditor's security. *Re Oasis* dealt with the proceeds of a wrongful trading claim, but the court nevertheless noted that the proceeds of preference actions are not company property, but rather, exist by virtue of liquidation and the liquidator's right of action, and are impressed with a trust in favour of the unsecured creditors. At pp. 181, the Court stated:

> Thus a right of action against directors for misfeasance which the liquidator (amongst others) can enforce under section 212 of the Act of 1986 and the fruits of such an action are property of the company capable of being charged by a debenture, because the right of action arose and was available to the company prior to the winding up. But with this can be contrasted the right of action by a liquidator, and the fruits of such an action, for fraudulent preference or fraudulent or wrongful trading, which are not the property of the company and are not caught by a debenture: see *Gough*, *Company Charge* s, 2nd ed. (1996), p. 122.

36 Similarly, Air Canada notes that Millet J. in *In Re M.C. Bacon Ltd.*, [1991] Ch. 127 (Ch.D.), a case concerning whether the liquidator was entitled to recover its fees for the pursuit of a preference action, continued to apply *Re Yagerphone* to the determination of whether that preference action was properly brought so as to constitute an expense of the winding up payable out of the assets of the company. In making that determination, Millet J. noted that a preference action can only be made by a liquidator or administrator, and not a debentureholder because a debenture holder is bound by payments in the ordinary course of business even if the payment is preferential, whereas the liquidator is not. Millet J. wrote at p. 137:

> It was thus established long before 1986 that any sum recovered from a creditor who has been wrongly preferred enures for the benefit of the general body of creditors, not for the benefit of the company or the holder of a floating charge. It does not become part of the company's assets but is received by the liquidator impressed with a trust in favour of those creditors amongst whom he has to distribute the assets of the company: see In re Yagerphone Ltd. [1935] Ch. 392.

Fraudulent preferences are only void as against the trustee

37 Counsel to Air Canada submits that fraudulent preferences under s. 95 of the *BIA* are declared to be void *as against the Trustee* and not as against any other party, including secured creditors. Property recovered pursuant to a preference action is held by the Trustee for the benefit of the general body of creditors.

38 Air Canada submits that the judgment of Hood J. in *S-Marque Inc. v. Homburg Industries Ltd.*, [1998] N.S.J. No. 550 (S.C.) aff'd for diff't reasons [1999] N.S.J. No. 94 (C.A.), endorses this view. In that case the deficit in the security of the secured creditor could not be paid in priority from the proceeds of a preference action. Rather the secured creditor could claim for the deficit as an unsecured creditor. Hood J. reviewed the jurisprudence relating to the entitlement to the proceeds of preference actions and concluded at para. 147:

> The effect of all these decisions is that overturning a fraudulent preference puts the property back in the hands of the trustee. The transaction is void as against the trustee in bankruptcy. The property does not, however, revert to the bankrupt to be available as part of the security over which a secured creditor has rights of seizure. [Emphasis added.]

39 To similar effect, Air Canada submits that the court in *Canadian Imperial Bank of Commerce v. Canotek Development Corporation* (1997), 35 O.R. (3d) 247 (C.A.) ("*Canotek*"), stated at p. 256 that "[s]ection 95 renders a fraudulent preference void as against the trustee in bankruptcy; it does not render it void as against a secured creditor".

40 In *Canotek*, the bank held a general security agreement and chattel mortgage on the assets of F. Inc. (the debtor), which went bankrupt, but C. Corp, (the landlord of F. Inc.) levied distress against F. Inc without granting sufficient time for the tenant to rectify the situation. The court found that there was a fraudulent preference against the trustee, but not as against the bank. However, the landlord might still have rights under s. 136(1)(f) as a preferred creditor.

41 The court rejected the bank's argument regarding the reversal of priorities, stating at p. 251:

> However, the bank says that but for the premature sale the property distrained would have been property of the bankrupt and, thus, subject to the bankruptcy. In that case, the bank argues, it would have been entitled to its security as against the trustee. In short, the bank argues that it has been deprived of the right to take advantage of the assignment in bankruptcy to gain priority in the goods and their proceeds over the trustee in bankruptcy. Since the trustee would have priority over the landlord's distraint, the bank would thus have priority over the landlord as secured creditor in the bankruptcy. This is a tail-chasing type of priority problem which must be resolved by looking at the relationship between the true parties to the dispute. In this case, the bank never did have a priority over the

> landlord once the landlord distrained against the goods. The artificiality of looking to the bankruptcy proceedings to give the bank something the law never intended it to have is obvious, and should not be countenanced by the court.

42 Intriguingly, the Court while noting, at p. 256, that "[g]enerally, provincial law governs priorities between various secured creditors, and also between secured creditors and landlords", went on to state that ... outside bankruptcy the landlord prevails in facts such as these, and the incidence of bankruptcy should in no way alter this situation."[Emphasis added.] *The Trustee is an impartial officer of the court*

43 Air Canada takes the position that the Trustee's position in respect of the proposed preference action is inconsistent with its role as an impartial officer of the court submitting that a trustee should not act as an advocate for any particular class of creditors. Instead, its role is to gather in the assets of the bankrupt and divide the proceeds in accordance with the scheme of the *BIA*: See *Re Beetown Honey Products Inc.* (2003), 46 C.B.R. (4th) 195 (Ont. S.C.) at para. 22, aff'd (2004) 3 C.B.R. (5th) 204 (Ont. C.A.).

44 Air Canada submits that in bringing this preference action, the Trustee seeks to realize a benefit solely for Lloyd's, a secured creditor. The Trustee has also failed to involve the unsecured creditors and it has failed to disclose competing considerations that might indicate that this preference action is unwarranted. While the Trustee may act for a secured creditor pursuant to s. 13.4 of the *BIA*, Air Canada contends that the record does not indicate that it has met the statutory preconditions to assisting a secured creditor. Air Canada submits that the purpose of s. 13.4 is to protect unsecured creditors' rights: See *Pratchler Agro Services Inc. (Trustee of) v. Cargill Ltd.* (1999), 11 C.B.R. (4th) 104 (Sask Q.B.) at para. 9.

45 Section 13.4 of the *BIA* provides:

> (1) No trustee may, while acting as the trustee of an estate, act for or assist a secured creditor to assert a claim against the estate or to realize or otherwise deal with a security that the secured creditor holds, unless the trustee has obtained a written opinion from independent legal counsel that the security is valid and enforceable against the estate.
>
> (1.1) Forthwith on commencing to act for or assist a secured creditor of the estate in the manner set out in subsection (1), a trustee shall notify the Superintendent and the creditors or the inspectors
>
> (*a*) that the trustee is acting for the secured creditor;
>
> (*b*) of the basis of any remuneration from the secured creditor; and

(*c*) of the opinion referred to in subsection (1).

(2) Within two days after receiving a request therefor, a trustee shall provide the Superintendent with a copy of the opinion referred to in subsection (1) and shall also provide a copy to each creditor who has made a request therefor.

46 Air Canada submits that the record before the court does not indicate that the Trustee has obtained a written opinion from independent legal counsel that the security in issue is valid and enforceable against the estate. There is also no evidence that the Trustee has notified the Superintendent in Bankruptcy and other creditors of such an opinion (if it exists), its intention to act for Lloyd's, or the details of any remuneration it may be receiving from the secured creditor.

The Trustee's Position

47 The Trustee's position is that the jurisprudence is somewhat unclear, but the weight of jurisprudence favours granting the proceeds of preference action to secured creditors possessing a fixed, rather than floating charge, a finding that is reinforced by the structure of the *BIA* and the policy considerations underlying the *BIA*. As a result, the proceeds of this preference action ought to be paid to the secured creditor.

The distinction between fixed and floating charges

48 The Trustee submits that Air Canada avoided a long-standing and obvious distinction between fixed and floating charges. Floating charges have been held to not attach to property that is the subject of a preference action. Conversely, fixed charges do: *Re Yagerphone*. This is because the secured creditor has no title when a charge is floating, yet gains priority where it is specific: *Bank of Montreal v. Innovation Credit Union,* [2010] 3 S.C.R. 3 at para. 46.

49 Counsel to the Trustee submits that certain courts have interpreted *Re Yagerphone* overbroadly. *Re Yagerphone* concerned a dispute as to the priority as between a liquidator and a debentureholder over the proceeds of a preference action. The court held that the debentureholder's security did not attach to the assets at the time that they were transferred such that, in that case, the secured creditor had no greater claim to those assets than any other creditor.

50 The Trustee acknowledges that *Re Maybank Foods* goes beyond the ratio in *Re Yagerphone*, yet contends that the overbroad interpretation of *Re Yagerphone* was based on a concession made by the respondent.

51 The Trustee submits that the weight of case law favours the view that floating charges do not attach to assets recovered pursuant to a preference action; but, fixed charges do. In support of this position, the Trustee notes that: *Re M.C. Bacon Ltd.* (which found that preference action proceeds enure to the benefit of the general body of creditors) concerned a floating, rather than fixed charge;

Re Oasis is the product of a technical reading of UK legislation; and *S-Marque Inc.* was affirmed for different reasons at the Court of Appeal, namely, that the debenture had not crystallized at the time that the asset was transferred away, such that the secured creditor was not entitled to the proceeds of a preference action. This is the same finding as the court in *Mohawk Sports Equipment* (1972), 17 C.B.R. (N.S.) 115 (Ont. S.C.), at paras. 16-17, which prevented the proceeds of a preference action being claimed by the holder of security that had not crystallized at the time of transfer.

52 The Trustee points out that this distinction is found throughout the case law. Roy Goode in *Principles of Corporate Insolvency Law,* 3d ed. (London: Sweet & Maxwell, 2005) notes at s. 11-140:

> All these cases assume that what is recovered by the liquidator either was never the property of the chargee or ceased to be so prior to the winding up as the result of the fact that the transfer in question overrode the charge. In such a case the chargee is not entitled to use the avoidance provisions to recover what he had lost or had never had. Where however, the charge was not overridden by the transfer and the property transferred is recovered, the charge continues to attach to the recovered property. [Emphasis added]

53 The Trustee further submits that in *N.A. Kratzmann Pty. Ltd. (In Liq.) v. Tucker (No. 2)* (1968), 123 C.L.R. 295 (Qld. C.A.), the court noted in obiter at p. 302 that "if specific property, to which a charge, validly created by the bankrupt prior to his bankruptcy, has attached prior to the time of its disposition, is subsequently recovered as a preference the trustee's title will be no higher or better than that of the bankrupt to which he has succeeded". In arriving at this conclusion, the court draws the distinction between specific property, that is subject to a charge, and over which the secured creditor will enjoy priority even if recovered pursuant to a preference, whereas property subject to a floating charge will not be subject to the charge when recovered by the trustee. The court reasoned at pp. 300-01:

> Now in bankruptcy the property of a bankrupt vests in his trustee upon the making of the sequestration order. The property which so vests is, of course, subject, in the hands of the trustee, to any charges validly created in relation to it by the bankrupt prior to the bankruptcy. The position of a secured creditor who has a charge on specific property is, of course, not in question; such property in the hands of the trustee will still remain subject to the charge. But where security has been given by a bankrupt over all of his assets and a payment to a creditor is made by him out of moneys subject to the charge and the payment is, as against the trustee, subsequently declared void as a preference the moneys paid, when recovered, will not be subject to the charge. In such a case it may be said that although the moneys paid as a preference were at the time of payment subject to the charge, the moneys recovered by the trustee are not the same moneys and that

they do not, by virtue of payment to the trustee, become moneys of the bankrupt or in any way subject to the charge; when recovered they become the moneys of the trustee and his title to them does not depend upon his succession to any title which the bankrupt had. It was, we think, in this sense that Bennett J meant in the passage that we have first cited that, applying the bankruptcy rules in a winding up,

> "... the sum of money, when recovered by the liquidators by virtue of s 265 of the Companies Act, 1929, and s 44 of the Bankruptcy Act 1914, did not become part of the general assets of Yagerphone Ltd, but was a sum of money received by the liquidators impressed in their hands with a trust for those creditors amongst whom they had to distribute the assets of the company."

The view which we have formed is, we think, borne out by the observations of Russell L.J. concerning the decision in *Yagerphone* case where, in *N.W. Robbie & Co. Ltd. v Witney Warehouse Co. Ltd.* he said:

> "... that a claim by the liquidator for repayment to him of a fraudulent preference was not subject to the debenture-holder's charge; a statutory right in and only in the liquidator to make such a claim could never have been property of the company subject to the charge."

It is of significance that his Lordship did not think that the decision in any such case could depend upon whether or not the charge had crystallized at the time when the payment to the creditor was made.

The case would be otherwise, of course, where a preference consists of the disposition of specific and identifiable property subject to a charge validly created in relation thereto by a bankrupt prior to his bankruptcy and where the avoidance of the disposition affects title to such property. That this is so seems to us to be clear as a matter of principle....

In such a case the result of the avoidance of the disposition is to revest the property in the trustee subject to the charge which the bankrupt had validly created prior to the bankruptcy. [Emphasis added; Footnotes omitted.]

The Structure of the BIA

54 The Trustee submits that the structure of the *BIA* favours giving the proceeds of a preference action to the secured creditor. Successful preference actions render transactions void as against the trustee as per s. 95 of the *BIA*. The property then vests in the Trustee as per ss. 67 and 71 of the *BIA*. However, the Trustee takes the property subject to the rights of secured creditors pursuant to s. 71, as the Trustee cannot obtain a greater interest in the goods than that enjoyed by the bankrupt: *Giffen (Re),* [1998] 1 S.C.R. 91 at para. 50; *Lefebvre (Trustee of),* [2004] 3 S.C.R. 326 at para. 37. Further, the Trustee reasons that division of the estate is subject to the rights of secured creditors pursuant to s. 136 of the *BIA*. As a result, secured creditors retain priority in those assets over which they had perfected security interests.

55 The Trustee submits that the court in *Re ASI Acoustical Supplies Inc.* (2000), 22 C.B.R.(4th) 174 (B.C.S.C.), noted that the fact that only the trustee can bring a preference action does not disturb the priority rights of creditors to the proceeds of preference actions, stating at para. 20: "[i]n any event the fact that only a Trustee can make a claim alleging *a* fraudulent preference does not change the priority position of a secured creditor.

56 The Trustee further submits that in *Agricultural Credit Corp. of Saskatchewan v. Featherstone (Trustee of)* (1996), 145 Sask. R. 161 (Q.B.), the court recognized that "[m]onies owing to a bankrupt, when collected by the trustee continued to be the property of the bankrupt and continue to be subject to the existing security interests. This includes monies realized through the efforts of the trustee" (citations omitted).

57 The case of *Royal Bank of Canada v. North American Life Assurance Co. et al.*, [1996] 1 S.C.R. 325, cited by the Trustee, is not analogous, but potentially somewhat informative. The court found that s. 91 (dealing with whether settled property falls back into the estate) is subject to s. 67, insofar as s. 67 governs the disposition of assets in the estate. The court bifurcated the inquiry as follows at paras. 44, 45, 46, 48 and 49:

> In reconciling ss. 67(1)(b) and 91 BIA, it is important to remember that the general scheme through which a bankrupt's estate is divided by the trustee among creditors involves two distinct stages. First, the Act provides that an insolvent person "may make an assignment of all his property for the general benefit of his creditors" (s. 49(1)), or that creditors "may file in court a petition for a receiving order against a debtor" (s. 43(1)). At the time of the assignment or receiving order, the trustee in bankruptcy is obligated to take possession of the assets forming the estate of the bankrupt. Thus, by operation of s. 71(2), the bankrupt's property passes to and vests in the trustee ...
>
> Once the bankrupt's property has passed into the possession of the trustee, the Act provides the trustee with the power to administer the estate ...

> During the property-passing stage of bankruptcy, the trustee is empowered under s. 91 of the Act to set aside certain settlements which have reduced the size of the estate. Thus, s. 91 outlines the circumstances in which a settlement will be voidable at the behest of the trustee in bankruptcy. If a settlement is declared void against the trustee, then the settled property reverts back to the bankrupt's estate, and falls into the possession of the trustee in bankruptcy ...
>
> ...
>
> However, the trustee is barred from dividing two categories of property among creditors: property held by the bankrupt in trust for another person (s. 67(1)(a)), and property rendered exempt from execution or seizure under provincial legislation (s. 67(1)(b)). While such property becomes part of the bankrupt's estate in the possession of the trustee, the trustee may not exercise his or her estate distribution powers over it by reason of s. 67.
>
> Thus, it can be seen that ss. 91 and 67 relate to two different stages of bankruptcy. Section 91 dictates that certain settled property will fall back into the estate of the bankrupt in the possession of the trustee, while s. 67 is directed at the exercise of administrative powers over the estate by the trustee. Where a settlement is void against the trustee under s. 91, then in normal circumstances, the trustee is empowered to administer the settled asset, and use it to satisfy the claims of creditors. However, in the special case where the asset is exempt under s. 67(1)(b), then the trustee is prohibited from exercising his or her distribution powers because the asset is not subject to division among creditors.

58 Counsel to the Trustee also references *Re Thorne, Ernst & Whinney Inc. and Gazzola et al.* (1989), 60 D.L.R. (4th) 590 (B.C.C.A.). In determining whether a landlord would be entitled to the proceeds of a preference action the Court of Appeal outlined the scheme of distribution as follows:

> Under the Bankruptcy Act the trustee is charged with gathering the assets of the bankrupt for the benefit of creditors and then distributing those assets pursuant to the scheme of distribution set out in s. 136 of the Act. Section 95 is in that part of the Act that deals with schemes and preferences. Pursuant to s. 95 the trustee is entitled to consider any transaction involving a creditor of the bankrupt and if that transaction occurred within three months prior to the bankruptcy, the trustee can take steps to seek to establish that the transaction be deemed fraudulent and void as against the trustee ...

> ...
>
> In due course, depending on the claims of secured creditors and those standing in priority to the landlord under the scheme of distribution established by s. 136 of the Act, if there are sufficient assets in the estate the landlord will then receive payment pursuant to the provisions of that section.

59 The Trustee suggests that this reasoning was endorsed in *Canotek* at p. 256 where the Court of Appeal held that provincial law governs priorities between secured creditors and landlords and the incidence of bankruptcy should not disturb the order of priority present outside bankruptcy.

The policy underlying the BIA

60 The Trustee submits that the policy underlying the *BIA* favours giving the proceeds of the preference action to the secured creditor, as this interpretation avoids altering priorities and nullifying a secured creditor's claim to collateral simply because a debtor has dealt with those assets preferentially. Otherwise, an insolvent person could defeat secured creditors' rights by granting a preference immediately prior to bankruptcy, with the resulting proceeds flowing to the benefit of unsecured creditors. This would be inconsistent with commercial sense, which the *BIA* seeks to protect.

61 The Trustee notes that the courts have disallowed attempts to alter priorities through unlawful means. In *Anron Mechanical Ltd. v. L'Abbe Construction (Ontario) Ltd. (Trustee of)* (1991), 5 C.B.R. (3d) 133 at para. 9 (Ont. Gen. Div.), the specific and identifiable property (traceable moneys), that had been impressed with a trust did not lose that quality simply by virtue of being recovered as fraudulent payments:

> If this were not so, a general contractor could then easily divert monies, defeat the rights of the unpaid subcontractors and thwart the whole purpose of the trust section of the Construction Lien Act. If he cannot divert the monies lawfully, as by assignment, then surely he cannot do so unlawfully, as by a fraudulent preference.

62 The Trustee submits that the proceeds of a preference action ought to be paid in accordance with the hierarchy established in the *BIA*. Unsecured creditors do share rateably under s. 141, yet their claim is expressly subordinate to preferred creditors under s. 136, whose claim is itself subject to the rights of secured creditors.

63 As a final point, the Trustee submits that this proposed action is not inconsistent with the role of the trustee. The trustee may act for secured creditors pursuant to s. 13.4 of the *BIA* if they have

obtained a written opinion from independent legal counsel that the security is valid and enforceable. The Trustee contends that such an opinion was obtained and submitted in the Trustee's report filed on June 30, 2010.

64 The Trustee also contends that it provided notice to the Superintendent and notified creditors before any action was taken on behalf of the lenders in accordance with the February 2010 Order. Further, it has: provided notice of its independent security opinion; posted this notice; and provided notice that it was bringing a preference action with the expectation that it would pay over the proceeds of that action to the secured creditor, Lloyds. As the Trustee is not receiving any remuneration from secured creditors, it provided no notice that it was receiving remuneration from the secured creditor. Instead, the Trustee is funded by the Foreign Representatives who have been funded to date by monies in the estate.

2. Is the preference motion properly brought within the *CCAA* proceedings, or should it be reconstituted in the bankruptcy proceedings?

65 Air Canada submits that this preference action is improperly brought. A preference action pursuant to s. 95 of the *BIA* can only be taken in Bankruptcy proceedings or, pursuant to s. 36.1 of the *CCAA*, a monitor (appointed pursuant to s. 11.7) may pursue a preference action where a plan of compromise or arrangement has been proposed. This preference action is not brought in bankruptcy and is not brought pursuant to a plan of arrangement, while the Trustee, as an Information Officer, is unable to bring an action that is reserved to a monitor.

66 The Trustee submits that this Court dealt with this issue in its February 2010 Order dealt with this issue, with reasons reported at 2010 ONSC 1196. It held that concurrent *BIA* and *CCAA* proceedings are contemplated by Part IV; the preference motion is brought to maximize the Debtor Company's assets; failing to allow concurrent proceedings may preclude the review of what may in fact be a preferential transaction which is contrary to public policy; Air Canada commenced and then abandoned an appeal to this motion; such that, these issues are now *res judicata*. In any event, the Trustee contends that s. 42 of the *CCAA* intends for the *CCAA* to operate in tandem with the *BIA*: *Century Services Inc. v. Canada (Attorney General),* [2010] 3 S.C.R. 379 at para. 76.

3. Should the February 2010 Order be varied to provide that the Trustee has to comply with certain obligations under the *BIA*?

67 Air Canada notes that the February 2010 Order ought to be varied to ensure that the Trustee complies with its statutory obligations. To date, no proofs of claim have been sought from unsecured creditors, and no meeting of creditors has been convened to either consider the bankrupt's affairs, or hold a vote of the unsecured creditors to affirm the appointment of the Trustee, or substitute another trustee in its place, or to appoint inspectors to give direction to the Trustee. As a

result, Air Canada submits that an order directing the Trustee to comply with its obligations under the *BIA* ought to be granted.

ADDITIONAL COMMONWEALTH JURISPRUDENCE

68 The case of *Willmott v. London Celluloid Co.* (1886), 31 Ch. D. 425 (C.A.), appears to support the position of Air Canada, as the court held at pp. 435-36 that a preference action can only be pursued by a liquidator, while the proceeds are intended for the benefit of the general body of creditors: See also: *Re Quality Camera Co. Pty. Ltd.* (1965), 83 W.N. (Pt 1) 226 (N.S.W.S.C.); and *Bibra Lake Holdings Pty. Ltd. (in liq.) v. Firmadoor Australia Pty. Ltd*. (1992), 7 A.C.S.R. 380 (W.A.S.C.) .

69 Further support can be found in *Wily (in his capacity as Official Liquidator of Space Made Pty. Ltd. (in liq.)) v. St. George Partnership Banking Ltd.* (1999), 161 A.L.R. 1 (F.C.A.), in which no fraudulent preference was found as the payment was *to* a secured creditor, but the Federal Court of Australia helpfully mentioned three principles applicable to that context. The first being that a debtor is entitled to prefer creditors subject to the *Statute of Elizabeth* 13 Eliz 1 c 5. The second and third principles are detailed at p. 5 as follows:

> ... in insolvency, by which I mean bankruptcy in the case of a natural person and liquidation in the case of a company, legislation provides that, with certain limited exceptions, all unsecured creditors of a bankrupt or an insolvent company are to be treated equally: that is, their liabilities are to be discharged rateably. This principle can be found in bankruptcy statutes dating back to 1542 (see 34 & 35 Hen 8 c 4, s 1 which was concerned with absconding debtors) and in company statutes since the Winding Up Act of 1844 (7 & 8 Vict c 111); see now s 108 of the Bankruptcy Act and s 555 of the Corporations Law.
>
> The third principle is the recognition that certain dispositions made by a debtor who subsequently becomes bankrupt, or by a company that subsequently is wound up, should be recovered and be available to meet the claims of the creditors generally. Section 122 of the Bankruptcy Act is one example of the operation of this principle. Others are to be found in the Bankruptcy Act and the Corporations Law. Many other systems of law have comparable provisions. [Emphasis added.]

70 In *Wily,* the Court found that if there is no detriment to the unsecured creditors, there can be no preference. Consequently, it would be appear to be the case that if the proceeds of the preference action were to be co-opted entirely to the benefit of the secured creditors there would be no resulting benefit to the unsecured creditors, thereby precluding bringing a preference action in this situation. The Court in *Wily* stated at pp. 9-10:

> If one asks whether there is less money available for the general body of creditors by reason of the three payments to the bank the answer must be a clear No. The reason is that if the payments had not been made the property available for distribution among creditors would not have increased. The bank would have been entitled to receive payment out of the property in the hands of the liquidator in priority to the other creditors. Any payment out of property that is not available to meet the debts due to the other creditors cannot confer a preference in favour of the payee. In this case then, the other creditors are not any the worse off by reason of the payments to the bank.
>
> ...
>
> the short answer to the liquidator's submission is that provisions such as s 122 are designed to protect the statutory order of priority established by the Bankruptcy Act and, when it applies in a winding up, the statutory order established by the Corporations Law, the statutory order being the right to receive payments pari passu. Section 122 is not concerned to protect the rights of a creditor who is accorded priority by some other legislation, whether State or federal. [Emphasis added.]

(See also *St. Anne Nackawic Pulp Co. (Trustee of) v. Logistec Stevedoring (Atlantic) Inc.* (2005), 255 D.L.R. (4th) 137 (N.B.C.A.), which stands for the proposition that where a secured creditor is paid first there can be no fraudulent preference).

71 Additionally, McPherson J.A., who expressed concurring reasons in *Starkey v. Deputy Commissioner of Taxation* (1993), 11 A.C.L.C. 558 (Qld. C.A.) stopped short of endorsing the view in *Re Yagerphone* that preference proceeds are impressed in the hands of the liquidators with a trust for unsecured creditors, but did accept that since a secured creditor cannot bring a preference action a trustee should not be allowed to bring a preference action for the sole benefit of a secured creditor. The rationale for preventing secured creditors from sharing in the benefits of a right of action of a trustee was elucidated at pp. 566-67:

> If a secured creditor may not set in motion for his own benefit a procedure for avoiding preferences that exists for the benefit of the unsecured creditors, it is a logical consequence that he should not be able to claim the proceeds of avoiding such a preference when recovered. But it is another matter to say that the liquidator holds those proceeds in trust for the unsecured creditors if what is meant by that is a 'trust' in the full sense of the word, under which the unsecured creditors are equitable owners of the assets in winding up. There is little in recent decisions to support that view of the rights of creditors....

> It is secured creditors who, under the decision in Re Yagerphone Ltd, are denied a share in the proceeds of avoiding preferences in winding up. Unlike the claimant in that case the Commissioner here is not a secured creditor with rights that are enforceable against identified property independently of winding up.
>
> [Emphasis added.]

72 In *Bibra Lake Holdings Pty. Ltd. (in liq.)* v. *Firmadoor Australia Pty. Ltd*. (1992), 10 A.C.L.C. 726 (W.A.S.C.A.), Ipp J., in concurring reasons, held that fraudulent preferences are rendered void as against the liquidator only and the proceeds thereof do not form part of the assets of the company, writing at pp. 731:

> Moneys paid in circumstances which create an undue preference, and which are recoverable under s 451(1), are moneys which are recoverable for the benefit of the creditors and contributories. Such moneys cannot be said to have been the property of the company.
>
> ...
>
> Undue preferences are void as against liquidators, not as against companies. Section 451 confers upon liquidators the sole right to bring proceedings for the recovery of undue preferences. [Emphasis added.]

73 Since *Re Yagerphone*, the governing UK law has been amended, including, in particular, by the 1985-86 reforms to the *Insolvency Act* (U.K.), 1986, c. 45, with the consequence that the court can now make an order to restore the *status quo ante* as if there had never been a preference. Nevertheless, despite these broadened powers, Millet J. found in *Re M.C. Bacon Ltd. (No. 2)* that *Re Yagerphone* remained applicable at p. 137:

> It was thus established long before 1986 that any sum recovered from a creditor who has been wrongly preferred enures for the benefit of the general body of creditors, not for the benefit of the company or the holder of a floating charge. It does not become part of the company's assets but is received by the liquidator impressed with a trust in favour of those creditors amongst whom he has to distribute the assets of the company: see In re Yagerphone Ltd. [1935] Ch. 392 ....

> In my judgment that is still the law, notwithstanding section 239(3) of the Act of 1986 which empowers the court on finding a voidable preference proved to make such order as it thinks fit for "restoring the position to what it would have been if the company had not given that preference," and section 241(1)(c) which empowers the court to "release or discharge ... any security given by the company." Those powers are not intended to be exercised so as to enable a debenture holder to obtain the benefit of the proceedings brought by the liquidator.[Emphasis added.]

74 In *Tolcher v. National Australia Bank Ltd.* (2003) 44 A.C.S.R. 727 (N.S.W.S.C.), Palmer J. found that where a settlement was paid from the estate subject to a charge in the form of a general security agreement against all assets of the bankrupt (which was characterised as a floating charge, rather than a specific charge), the monies recovered pursuant to a preference action to impugn that settlement are not subject to the charge as the trustee's title is not dependent on the debtor's title, nor can it be in the case of a statutorily-provided right of action.

75 Somewhat more nuanced support for Air Canada's position can be found in the case of *N.W. Robbie & Co. Ltd. v. Witney Warehouse Co. Ltd*., [1963] 1 W.L.R. 1324 (C.A.). In that case, which had to do with whether certain debts could be set off rather than whether preference proceeds could accrue to secured creditors, Russell L.J. at p. 1338 rejected the suggestion that *Re Yagerphone* stands for the proposition that a charge cannot attach to assets acquired after the date of crystallization, noting instead that it stands for the proposition that proceeds from a liquidator's right to pursue a preference action, being a liquidator's right, cannot be property of the company subject to the charge. Russell L.J. stated at p. 1338:

> We were referred, in the course of the argument that there is no charge on the post-receivership "future assets," to a phrase in Kerr on Receivers (1963), 13th ed., p. 327, which says the charge would not attach to assets of the company acquired subsequent to the date of crystallisation." The authority cited is In re Yagerphone Ltd. The quotation, divorced from its context, is too wide to be supported, and if so divorced is not justified by that decision, which was that a claim by the liquidator for repayment to him of a fraudulent preference was not subject to the debenture-holder's charge: a statutory right in and only in the liquidator to make such a claim could never have been property of the company subject to the charge.
>
> [Emphasis added.]

76 Further support can be found in the case of *Horn v. York Paper Co. Ltd.* (1991), 5 A.C.S.R. 112 (N.S.W.S.C.), McLellan J. stated at p. 113:

> Where a transaction is avoided as against a liquidator by virtue of the operation

> of s 451 of the Companies Code (or s 565 of the Corporations Law) the liquidator is a necessary party to proceedings for the recovery of property or money based on such avoidance: see Kent v La Communauté des Soeurs de Charité de la Providence [1903] AC 220 at 226. This is because the transaction is avoided only against the liquidator, and the proceeds of recovery do not necessarily form part of the general assets of the company: see; Re Quality Camera Co Pty Ltd [1965] NSWR 1330; 83 WN (Pt 1) (NSW) 226 and; N A Kratzmann Pty Ltd (in liq) v Tucker (No 2) (1968) 123 CLR 295." [Emphasis added; See also *Bibra Lake*, holding to the same effect.]

77 In *Bayley v. National Australia Bank Ltd.* (1995), 16 A.C.S.R. 38 (Tas. S.C.), Wright J. was tasked with determining whether funds recovered via a s. 468 action under the Australian *Corporations Law* (which renders dispositions after a winding up void), as well as funds recovered pursuant to a preference action, were subject to a secured creditor's registered floating charge. Wright J. held that the disposition successfully challenged via s. 468 were void for all purposes, as if the payment had never occurred, such that the funds "remained the property of the company at all relevant times and upon being restored to the company by the liquidator's actions became once more subject to the respondent's floating charge." Wright J. then went on to deal with the question of whether the charge attached to the assets recovered pursuant to the preference action.

78 Wright J. held that the proceeds of a preference action were for the benefit of the general body of creditors. Wright J. noted that "unlike dispositions affected by s 468(1), preferences coming within the ambit of s 565(1) are not void in any absolute sense but are void as against the liquidator only." It was not necessary for Wright J. to decide whether this would mean that the recovered property could be said to be free and clear of any prior charges, (although it was noted that this may be true of specific property subject to a charge prior to a winding up order) since, in the circumstances of that case, the charge at issue was floating and had not crystallized prior to the liquidation proceedings, such that it did not attach to the funds that were preferred. Instead, those funds were held for the benefit of the general body of creditors. Wright J. concluded:

> ... irrespective of whether for some purposes the recovered funds may be viewed as the "property" of the company being wound up, in the present circumstances they are not property which was or could have been subject to the floating charge at the time that charge crystallised viz, the date upon which liquidation proceedings commenced. Thus, in my opinion, the fund constituted by those moneys is not available to the respondent, but is distributable to the general creditors subject only to the statutory priorities provided by the Corporations Law.

79 The import of the words "void as against the trustee" was the subject of judicial consideration by the New South Wales Court of Appeal in *National Acceptance Corporation Pty. Ltd. v. Benson & Ors* (1988), 13 A.C.L.R. 1 (N.S.W.S.C.A.), where the Court held that the use of the word "void"

in s. 368 of the Companies Code in question (which is similar to s. 468 of the Corporations Law considered in *Bayley*) "... means at least void for all purposes related or incidental to the administration of the winding up of the company" in contrast to the use of the word "void against the trustee" in their *Bankruptcy Act* which is more narrow. On this point, the Court noted that in *Commercial Bank of Australia v. Carruthers* (1964), 6 F.L.R. 247 (F.C.A.), Manning J. "held that the provision did not produce the result that the preferential payment was void against anyone else than the Trustee in Bankruptcy" (emphasis added).

80 Andrew Keay in "The Effects of a Successful Action by a Liquidator to Avoid a Pre-Liquidation Transaction" (1996) 15 (2) U. Tasm. L. Rev. 236 notes that the Australian bankruptcy regime has changed such that now transactions are no longer said to be "void as against the liquidator" but rather "voidable", and further, recovery vests in the company. He submits at p. 241 that this is a difference without a distinction as in the U.K., where the *Insolvency Act* grants the court broad powers to void fraudulent preferences and restore the position to the *status quo ante*, the courts have continued to apply *Re Yagerphone*. For instance, in *Re M.C. Bacon Ltd. (No. 2)*, *Re Yagerphone* was again endorsed as holding that secured creditors cannot recoup the proceeds of a preference action despite a similar change in wording as Australia's under the U.K. *Insolvency Act*.

81 In that article, Andrew Keay also notes that *Re Yagerphone* has existed for a long period of time and the government had the option to disturb this judicial practice but did not do so, nor is there evidence in the speeches of Parliament or the Explanatory Memorandum relating to the U.K. Bill that changed the U.K. *Insolvency Act* most recently that a change in judicial practice was contemplated, let alone required.

82 In addition to Andrew Keay's comments, it should be recalled that s. 95 of the *BIA* is worded more restrictively than the U.K. or Australian preference provisions, rendering fraudulent preferences void against the trustee only.

83 Andrew Keay does not regard reversing priorities as a problem, so much as a function of the legislative scheme itself. He writes at p. 264, in relation to the reversal of priorities:

> With respect, it appears that this argument overlooks the fact that bankruptcy or liquidation changes everything. While the company continues to exist, it is no longer directed by directors, and it is not run for the benefit of the shareholders. A liquidator acts on behalf of the company and he or she does so for the general body of creditors. Liquidation produces a whole new set of relationships and duties. While a secured creditor may argue that the general creditors are sometimes unjustly enriched by receiving the benefits of a recovery, the rebuttal to that might be that those creditors were prejudiced before liquidation because they did not receive any benefit from the voidable transaction and, in any event, they have suffered losses as a result of the liquidation. [Citations omitted; emphasis added.]

84 It could be argued that while priorities may well be reversed, as held in the case law, this stems from the role of the trustee. The status of the trustee is tripartite: as a successor in title, as a representative of creditors and finally, and importantly, the trustee has independent status under either federal or provincial law to avoid certain transactions: *Roderick Wood, Bankruptcy and Insolvency Law* (Irwin Law: Toronto, 2009) at pp. 180-81. As such, as Professor Wood notes at p. 82 the principle that a trustee "steps into the shoes" of the bankrupt and acquires the bankrupt's property "warts and all" "does not operate where bankruptcy or other legislation gives the trustee a power to subordinate or avoid certain property rights of third parties. In such cases, the trustee may have a better right to the asset than that held by the bankrupt."

85 This may constitute an oddity, but the danger of legislative intrusion outweighs any possible unfortunate consequences from the reversal of priorities. While the legislative measure could be an oddity, this would not be anomalous. As Professor Ian Fletcher writes in *The Law of Insolvency,* 4th ed. (London: Sweet & Maxwell, 2009) of the legislative history of British bankruptcy law at pp. 796-97 as follows:

> ... the legislative history is scarcely homogeneous, but is more accurately described as one of almost perpetual accretion and revision amid shifting socio-political influences. It must be submitted that the current position, in terms of policy and principle, is both muddled and confusing. It has resulted from the historic lack of a co-ordinated, thought-through approach to our law of credit, security and insolvency, amounting to a persistent failure ... to address the essentially interlocking and inter-dependent nature of these vital areas. Consequently, the law has become beset by anomalies and inconsistencies, particularly concerning the operation of the pari passu principle, which are in some instances squarely at odds with commercial and social realities....

86 However, there is also jurisprudence and commentary in support of the Trustee's position. Doyle C.J., for the majority, in *Fresjac Pty. Ltd. (In Liq, Re Campbell v. Michael Mount PPB),* (1995), 65 S.A.S.R. 334 (S.A.S.C.), approved of *N.A. Kratzmann.* This was cited by counsel to the Trustee, and reconciled many of the prior Commonwealth cases mentioned above <u>by distinguishing the issue of who possesses the right to bring a preference action, from the issue of the entitlement to the proceeds of such actions</u>. The Court in *Fresjac* was faced with the issue of to whom the proceeds of a s. 468 action by the liquidator, which renders dispositions of property after the commencement of winding up void, accrue. Doyle C.J. noted that the purpose of this section is identical to the purpose underlying preference actions, writing at pp. 341-42 "... both have an eye to the preservation of assets, to the preservation of the *status quo*, and to a later orderly distribution of assets among creditors, <u>subject to the rights of secured creditors</u>" (emphasis added).

87 In *Fresjac,* Doyle C.J. disagreed with Wright J.'s conclusion in *Bayley* that funds rendered void under s. 468 were at all times the property of the company and became subject to the charge once restored to the company. Doyle C.J. opined that such a characterization is artificial. The funds

recovered were not the same funds, and title could not be revested, although this could occur in the case of land or identifiable chattel. Instead, the company would have a claim to recover an equivalent amount of money and its entitlement to the funds of s. 468 is a separate question from the right to impugn a transaction. Wright J.'s reliance upon the fact that a s. 468 action is "void", whereas a preference action is "void as against the liquidator" is, in Doyle C.J.'s view at p. 344, misplaced, as those words "control who may invalidate the preference, and to identify the liquidator as the person with that right, not to decide or determine who is entitled to the proceeds."

88 In this regard, Doyle C.J.'s analytic framework is noteworthy and worth setting out. It was noted that there is a "need to distinguish between the avoiding effect of the section, the location of the right to recover property disposed of by the company in a transaction avoided by the section, and the entitlement apart from that to rely upon the avoiding effect of the section." Doyle C.J. wrote at p. 344-45:

> The preference cases indicate, in my opinion, that the right to recover property disposed of in a transaction avoided as a preference belongs to a trustee in bankruptcy or liquidator, and property recovered by the exercise of that right will not vest in a secured creditor unless the exercise of the right should cause the revesting of title in specific property subject to a security.
>
> ...
>
> ... the location of the right to assert voidness does not also determine the location of the right to proceeds recovered after the cancellation of a void transaction.
>
> ...
>
> The mere right to assert or rely upon voidness cannot, as a matter of logic, give rise to a right to recover the property disposed of by the void transaction.
>
> The right to recover property disposed of in a transaction voided by s 468 is not property of the company, and the proceeds of the exercise of the right do not fall to be treated as property of the company caught by pre-existing charges or security but, in my opinion, specific property the subject of a charge or security will, if recovered, again be subject to that charge or security.
>
> On this approach, the right to recover property the disposition of which is

> avoided by s 468 is not a right to which a charge or security will attach.
>
> In addition, in my opinion money recovered as the result of the avoidance of a preference or because a payment is void is not to be regarded as property of a company to which a charge or security can attach.
>
> These conclusions emphasise the similarity between the preference provisions and s 468, despite the difference of language (void as against the liquidator and void) and despite the difference in the stages before liquidation to which they apply and the differences in the manner in which they operate.
>
> On the other hand they avoid the oddity (as some would see it) of a better result for a secured creditor in respect of a void payment, and the oddity of a remedy conferred for the purposes of a liquidation working for the benefit of the secured creditor. I do not pretend the result which I have reached is obvious, or that the contrary arguments are lacking in substance. [Emphasis added.]

89 In addition, in *Bank of New Zealand v. Essington Developments Pty. Ltd. & Ors,* (1991), 5 A.S.C.R. 86 (N.S.W.S.C.), it was held that a secured creditor has the benefit of a liquidator's recovery of assets *in specie* over which a secured creditor has a charge. McLelland J. wrote at pp. 89-90:

> The position of a creditor with a charge over all the assets of a company and a receiver appointed by that creditor appears to be that if as a result of the avoidance of the transactions property is recovered in specie, then that property is included in the assets of the company which are subject to the charge and which therefore are available to the receiver for the benefit of the secured creditor. On the other hand, moneys which are recovered merely because payments have been avoided as preferences do not come within the general assets of the company available for the secured creditor and the receiver, but may be utilised by the liquidator for the purposes of the liquidation, and in particular for the benefit of unsecured creditors. [Emphasis added.]

90 In *Re Shapland Inc.,* [2000] B.C.C. 106 (Ch.D.), the court appears to be of the view that a trustee can pursue a preference action for which the benefits will accrue to the secured creditor (although in that case unsecured creditors would actually benefit as well) in stating at p. 110:

> Mr Goodison submitted that I should make no such order, on the ground that it would benefit only the bank, which was a secured creditor, and the power under s. 239 was conferred to benefit unsecured creditors, not secured creditors. I am

> very doubtful that this submission would be correct, even if the bank's claim were fully secured. However, on the facts of this case, it is not: the indebtedness of Shapland to the bank greatly exceeds the value of the property, so that a large part of the bank's claim is unsecured. Furthermore, the bank's security has been challenged, so that it would be wrong for me to proceed on the assumption that it is unquestionably a secured creditor. Lastly, the bank and the liquidator, who is financed in these proceedings by the bank, have agreed that after payment of the costs and expenses of the winding up, ten per cent of the proceeds of sale of the property are to go to unsecured creditors. Accordingly, the setting aside of the charge will benefit unsecured creditors, and the factual basis for Mr Goodison's submission is not made out. [Emphasis added.]

91 In *The Law of Insolvency,* Professor Fletcher would appear to provide some support for the Trustee's position, in claiming that the purpose of a preference action is to restore the situation to the *status quo ante,* and that the court may make such order to achieve that purpose as it sees fit, such that the idea that the proceeds of the action are not subject to the rights of secured creditors would be put into doubt. The new broad power to strike down fraudulent preferences, declare them void, and make any order that is just, was introduced in the 1985-86 reforms to the *Insolvency Act* in England. However, as previously noted, this form of relief is not replicated in the *BIA*.

92 Professor Fletcher also notes that the trustee's title is subject to various equities. He states at p. 246 that in the individual debtor context, whereby preferences can be declared void to restore the *status quo ante* (much like in the company debtor context), "the trustee is essentially a *successor* to such title as the bankrupt actually had at the time of his adjudication, including any limitation or imperfections in that title, and can enjoy no better position in relation to the property than did the bankrupt himself formerly" (emphasis in original; citations omitted).relying on *Johnson v. Smiley* (1853), 51 E.R. 1019 (Ch.D.); *Mapleback, Re* (1876), 4 Ch.D. 150 (C.A.); *Garrud, Re* (1880), 16 Ch.D. 552 (C.A.), per James L.J.; *Beeston, Re*, [1899] 1 Q.B. 626 (C.A.) at p. 610 per Lindley M.R.

93 More forcefully, he states at p. 247 "[a]ll such rights as might have been exercised by third parties prior to bankruptcy may be exercised after adjudication, and no action by the trustee can be effective to gain priority over such vested rights: unless the property can be disclaimed, the rights remain undisturbed" relying on *Anderson, Re*, [1911] 1 K.B. 896 (Ch.D.).

94 The Trustee's position is supported by additional academic literature. Rebecca Parry in "The Destination of Proceeds of Insolvency Litigation" (2002) 23(2) Comp. Law. 49, is concerned about the reversal of priorities that occurs where secured creditors cannot recoup the benefits of a preference action brought by a trustee under English law, especially given the anomaly that many preference actions could be pursued as misfeasance claims that do not give rise to the same result. This is because in the misfeasance context, amounts recovered are recoverable by secured creditors: See *Re Produce Marketing Consortium Ltd. (No. 2)*, [1989] B.C.L.C. 520 (Ch.D.); *Re Asiatic Electric Co. Pty. Ltd. (in liq.)* (1970), 92 WN (N.S.W.S.C.) at pp. 362-64. The remainder of her

article deals primarily with the particular wording of the U.K. law.

95 Lee Eng Beng in "The Avoidance Provisions of the Bankruptcy Act 1995 and their Application to Companies" (1995) Sing J. Legal Stud. 597 notes that even with respect to preferential dispositions of specific property, the right to recover the assets vests in the liquidator such that a chargee cannot be entitled to the fruits of that recovery, especially since the process itself is intended for the benefit of unsecured creditors rather than secured creditors, as the latter exist outside of the bankruptcy regime. Nonetheless, Lee Eng Beng acknowledges the rights of secured creditors to trace monies at p. 632:

> While the property which has been disposed of may have been validly charged, the fact of it being wrongfully disposed of gives rise to the chargee's right under the general law to trace against the disponee and nothing more. The rights and remedies of secured creditors are conferred by the general law and they are not to be reinforced by statutory provisions designed to provide an equitable debt collection system for unsecured creditors. Of course, <u>any right of a secured creditor which exists at general law would override any right of the liquidator or trustee in bankruptcy to proceed against the assets by virtue of any statutory provision, as the latter cannot be in a better position than the company or bankrupt, as the case may be. It follows that if a secured creditor has the right to recover the assets transferred away in breach of his security rights and the liquidator or trustee in bankruptcy recovers the assets pursuant to the statutory provisions, any recovery by the latter must be held for the benefit of the former in so far as they would have been recoverable by the secured creditor</u>. [Emphasis added.]

96 Gerard McCormack in "Swelling Corporate Assets: Changing What is on the Menu" (2006) 6 J. Corp. L. Stud. 39 advances five reasons at pp. 56-57 for doubting the line of cases affirming *Re Yagerphone,* two of which are not peculiar to the English context:

> 1. *Re Yagerphone g* ives rise to the unprincipled anomaly that certain preference actions can also constitute misfeasance actions, yet only in the latter case are payments subject to the rights of secured creditors.
> 2. Too much emphasis is placed on the liquidator's independent status which is merely an administrative convenience. He states that "the fact that proceedings are brought by the liquidator or administrator might be seen as <u>largely procedural</u>. The liquidator or administrator are not acting in their own individual rights but rather by virtue of the office they hold in relation to a particular company. In a broad sense the proceedings are brought on behalf of the company in question." (Citations omitted; emphasis added.)

97 Nancy Sanborn supports this interpretation, admittedly in the U.K. context. She writes in

"Avoidance Recoveries in Bankruptcy: For the Benefit of the Estate or the Secured Creditor?" (1990) 90 Colum. L. Rev. 1376 at 1399-1400 supports the above authors writing:

> The proposition that all amounts recovered must be available for administrative expenses and unsecured claims and interests, without recognition of any security interest in the recovery because avoidance powers are exercised for the benefit of the estate, fails to distinguish between two separate functions of the bankruptcy process. One function is to maximize the value of the pool of assets to which all claimants and interest holders will look for payment. Transfers are avoided, then preserved or recovered, to serve this function. The estate benefits from the exercise of these powers even if a creditor possesses a security or beneficial interest in the property.
>
> A separate issue, how entitlements to the accumulated pool of assets should be allocated, should be resolved primarily by nonbankruptcy law. A secured creditor should be afforded the same protections that would have been available to it under state law if no bankruptcy had ensued. [Citations omitted].

ANALYSIS

98 The foregoing review of jurisprudence confirms the submission of the Trustee, namely, that the jurisprudence is unclear and inconsistent. However, it seems to me that, with a consistent application of (i) insolvency principles; and (ii) personal property security principles, the jurisprudence can be reconciled.

99 Both the Trustee and Air Canada make extensive reference to the English decision of *Re Yagerphone*. *Re Yagerphone* has been cited by some Canadian courts to stand for the proposition that secured creditors have no claim to the proceeds of a preference action.

100 Counsel to the Trustee submits that, read properly, the holding in *Re Yagerphone* is, in fact, narrower. I agree.

101 In *Re Yagerphone*, the court considered a priority dispute between the liquidator and a debenture holder over the proceeds of a preference action. In reaching its conclusion, the court focussed on the nature of the debenture holder's security. The court observed that at the time the preference was given, the debenture holder's charge was still floating and therefore had not attached to the assets of *Re Yagerphone*:

> On January 17, 1933, the creditor to whom the money was paid and from whom the money was recovered was a creditor Yagerphone, Ld. When Yagerphone, Ld. paid to the creditor the 240 pounds 11s. 2d. that sum, in my judgment ceased to be the property of Yagerphone, Ld. The payment to that creditor could not have

> been attacked or impeached, unless within three months from the date of payment, the liquidation of Yagerphone, Ld. had begun, and, in my judgment, at the date when the security contained in the debenture crystallised, the sum of 240 pounds 11s. 2d. was not the property of Yagerphone, Ld....

102 As counsel to the Trustee points out, at the time the preference was given by the debtor, the assets transferred were not subject to the debenture holder's security and when the debenture holder's security was crystallized, the debtor's estate did not extend to the assets that had already been transferred on account of the preference. On this basis, the court found that the debenture holder's security did not attach to those assets when they were eventually returned to the estate.

103 Counsel to the Trustee goes on to submit that, from a policy perspective, the holding in *Re Yagerphone* is not unreasonable, as, in particular, because the debenture holder's security was floating it had no claim to the assets. When these assets were brought back into the estate, the court's decision that all creditors share in those assets is consistent with the fact that the "fraud" occurred against all of the debtor's creditors.

104 In *Mohawk Sports Equipment* Houlden J. (as he then was) applied *Re Yagerphone* in circumstances which involved a floating charge that had not crystallized. The court held that the proceeds "cannot be claimed by the debenture holder as it was not part of the property of the debtor company at the time the security was crystallized".

105 Counsel to the Trustee further submits that in subsequent cases, the holding in *Re Yagerphone* has been summarized more broadly to apply to secured creditors generally. Reference was made to *Re Maybank* where at paragraph 2 the court stated:

> It is conceded by the respondent that the monies recoverable by a trustee from a creditor who has been preferred do not become part of the general assets of the bankrupt estate subject to the claims of secured creditors but rather are received by the trustee subject to a trust in favour of the creditors represented by the trustee: Re Yagerphone, Ltd. (1935) 1 Ch. 392 (Ch. D.).

106 It is the Trustee's submission that the concession in *Maybank Foods* goes beyond the ratio in *Re Yagerphone* as the reasoning in *Re Yagerphone* does not necessarily follow the circumstances in which a secured creditor holds a fixed charge over the assets of the debtor. Counsel goes on to submit that where the secured creditor holds a fixed charge, the policy considerations are different. Unlike a floating charge, a fixed charge gives the secured creditor a property interest in the debtor's collateral that attaches at the time the charge is granted. Reference was also made to the recent decision of the Supreme Court of Canada in *Bank of Montreal v. Innovation Credit Union*, [2010] 3 S.C.R. 3, which, in turn referred to the case of *Royal Bank of Canada v. Sparrow Electric Corp.,* [1997] 1 S.C.R. 411, in which the distinction between a fixed and a floating charge was explained at para. 46:

> The critical significance of the characterization of an interest as to being fixed or floating, of course, is that it describes the extent to which a creditor can be said to have a proprietary interest in the collateral. In particular, during the period in which a charge over inventory is floating, the creditor possesses no legal title to that collateral ... However, if a security interest can be characterized as a fixed and specific charge, it will take priority over a subsequent statutory lien or charge; in such a case, all that the lien can attach to is the debtor's equity of redemption in the collateral....

107 The distinction between a fixed and floating charge and considering whether the charge has crystallized is not a new concept. The issue was also live in *Maybank Foods*.

108 In *Maybank Foods*, the respondent was a secured creditor of the estate. The estate had been engaged in three actions in Nova Scotia referred to as the Food Group Litigation, the Provisioners Litigation, and the Seaway Litigation, respectively. The trustee requested orders that the proceeds from such litigation were the property of the estate free and clear of the secured claim of the respondent.

109 At para. 2 of the decision, Saunders J. referenced the Provisioners Litigation and the Seaway Litigation as involving claims against preferred creditors. It was in this context that the concession was made by the respondent that the monies recoverable by the trustee would not form part of the general assets of the estate.

110 However, at para. 3 of the decision, Saunders J. addresses the claim against Food Group:

> The claim against Food Group was in respect of an account receivable. Food Group unsuccessfully defended the claim of the trustee on the basis of set-off. It was held that in the circumstances there was no mutuality, because at the time the bankrupt became indebted to Food Group, the receivable was being claimed by another secured creditor, Citibank under a crystallized charge. Upon the bankruptcy, the receivable of Food Group vested in the trustee subject to the secured claim of the predecessor in title of the respondent. Accordingly, the respondent may assert a right to the proceeds of the Food Group Litigation unless defeated by some principle or a statute. The situation is different from the other two actions where the respondent had no charge on the property being claimed by the trustee and the trustee was asserting a statutory right unavailable to the respondent. Here, the respondent has a charge on the receivable being claimed from Food Group. The trustee argued the respondent could not have successfully claimed against Food Group because Food Group would have been entitled to a set-off which in its submission made the situation analogous to the other two actions. I cannot accept that argument. The action of Citibank in crystallizing its charge foreclosed the Food Group from successfully asserting the set-off

> defence. In my opinion, the respondent who also had a charge against that asset could assert along with the trustee that set-off is not available notwithstanding the charge to the respondent may not have crystallized before the claim of Food Group against the bankrupt arose. There is, in my opinion, no basis in statute or principle preventing the respondent from claiming the net proceeds of the Food Group action.

111 Justice Saunders endorsed the record as follows:

> Net proceeds (after deducting of costs and disbursements) of Food Group Litigation are subject to the secured claim of the respondent. Proceeds of the Provisioners Litigation and the Seaway Litigation are free and clear of such claim. The costs and disbursements with respect to the Provisioners Litigation and the Seaway Litigation should not be paid out of the assets of the estate that are subject to the secured claim of the respondent unless that claim has been satisfied in full. Costs to the trustee and to the respondent out of the estate on a solicitor-and-client basis.

112 The distinction between a fixed charge and a floating charge was also the subject of the decision of the Nova Scotia Court of Appeal in *S-Marque*.

113 In *S-Marque*, the Nova Scotia Supreme Court found that the proceeds of a preference action will inure to the benefit of the unsecured creditors for two reasons:

(a) first, the court relied on the decision *In Re Yagerphone*; and
(b) second, the court cited a number of decisions to the effect that only a trustee can void a preference action.

114 The decision was affirmed on appeal but the Court of Appeal decided the priority issue for different reasons. The Court of Appeal focussed on the fact that the secured creditor held a floating charge and that the preference occurred "before the debenture crystallized". As counsel to the Trustee reasoned, as in *Mohawk Sports Equipment*, the court determined the matter on the basis that the secured creditor "never had a fixed charge on these assets when the debenture crystallized".

115 Counsel to the Trustee submits that the court considered the priority rights of secured creditors to proceeds from a preference action and that in the 2000 British Columbia Supreme Court decision, in *Re ASI Acoustical Supplies Inc*., the court squarely addressed the fact that only a trustee can make a claim for fraudulent preference under the *BIA*. Counsel to the Trustee submits that the court noted that, while the *BIA* gave that right to the trustee, it did not change the priority rights of creditors to the proceeds.

116 In my view, the *ASI Acoustical* decision does not stand for the proposition put forth by counsel to the Trustee.

117 The matter came before the court by way of an appeal by the trustee for *ASI Acoustical* from a decision of the Registrar, [2000] B.C.J. No. 1987, refusing to approve the payment to the trustee of its fees and disbursements. The Bank of Nova Scotia took security in the form of a general security and assignment of accounts receivable. The security was ultimately assigned to Mr. Willsie.

118 Prior to bankruptcy, ASI bought materials from Winrock and owed Winrock around $56,000. Winrock then bought a substantial amount of ASI inventory. Winrock owed ASI approximately $45,000 for the inventory, but resisted payment claiming a right of "contra account". The trustee wrote to Winrock noting that a subsidiary company Hubcity owed part of the money to ASI and therefore the claim of "contra account" could not be made out. The trustee also alleged that the Winrock claim was a preference on the basis that the sole reason Winrock bought the inventory from ASI was to reduce its claim in the bankruptcy.

119 Ultimately, the matter was settled. The position of the trustee was that the matter was settled on the basis that the purchase of inventory was a fraudulent preference under the provisions of the *BIA* and because this remedy is not available to the secured creditor, the money obtained from the settlement was an asset of the estate.

120 The registrar held that there was no dispute that the account receivable from Winrock was covered by the security interest, and the fact that there were negotiations and the claim was eventually paid because the trustee alleged that there was a fraudulent preference, did not convert the asset into some other kind of asset not subject to the security interest. The registrar therefore found that the proceeds of the claim should not appear on the statement of receipts and disbursements as an amount available to the estate.

121 At the hearing before Martinson J. on appeal, the creditors disputed the characterization of the transaction as a fraudulent preference. The only evidence before the registrar was that there had been an allegation of a fraudulent preference by the trustee, that no claim had been commenced by the trustee and that there was a negotiated settlement with Winrock.

122 Justice Martinson concluded that it was open to the Registrar, based on the material before her, to conclude that the settlement monies were accounts receivable and subject to the security interest. It was in this context that the reference which was cited by counsel to the Trustee: "[i]n any event, the fact that only a trustee can make a claim alleging a fraudulent preference does not change the priority position of a secured creditor" was made.

123 From my reading of *ASI Acoustical*, the significant point is that the court recognized that in the circumstances of that case, the fact that a fraudulent preference action had commenced, did not preclude the ability of a secured creditor to realize on security or to follow the proceeds from security in accordance with the specific security agreement.

124 This position is again recognized in *Agricultural Credit Corp. of Saskatchewan*, where the

court noted:

> Monies owing to a bankrupt, when collected by the trustee continue to be the property of the bankrupt and continue to be subject to the existing security interests. This includes monies realized through the efforts of the Trustee. (Holy Rosary Parish (Thorold) Credit Union Limited v. The Premier Trust Company, [1965] S.C.R. 503); Re Stadnik (Bankrupt) (1991), 90 Sask. R. 12 (QB); Re Moore (Bankrupt) (1989), 79 Sask. R. 63 (C.A.).

125 Counsel to the Trustee submits that the conclusion of the court in *Re ASI Acoustical* is consistent with a long line of jurisprudence that holds that monies recovered by the trustee are subject to the rights of secured creditors.

126 It seems to me that this statement is too broad. In my view, the focus has to be on whether or not the secured creditor had rights in the collateral at the time of the suspect transaction.

127 In *Re Yagerphone*, the debenture holder's security was floating and the debenture holder had no claim to the assets recovered by the liquidation.

128 In *Mohawk*, the floating charge had not crystallized.

129 In *Maybank*, the court recognized that the secured creditor could have a claim, under a crystallized charge.

130 In *S-Marque*, the secured creditor held a floating charge and the preference "occurred before the debenture crystallized".

131 In *ASI Acoustical*, the court concluded that it was open to the registrar to conclude that the settlement monies were accounts receivable and subject to the security interest.

132 In *Agricultural Credit Corp*., monies owing to a bankrupt on account of shares in the Saskatchewan Wheat Pool, when collected by the trustee continued to be the property of the bankrupt and subject to the existing security interest. It was not a preference action.

133 *Re Yagerphone* arose in the context of a regime dominated by fixed and floating charge debentures. In Ontario, since the enactment of the *Personal Property Security Act*, R.S.O. 1990, c. P-10 ("*PPSA*"), security agreement do not generally refer to fixed and floating security, but the concepts of fixed and floating charges is still recognized. (See *Bank of Montreal v. Innovation Credit Union, supra*.)

134 Under the *PPSA* regime, the issue that has to be analyzed is whether or not the debtor had the ability to transfer the collateral charged by the security agreement to a third party free and clear of the security interest.

135 It seems to me that, if the debtor was in a position to transfer the collateral free and clear of the interest of the secured party, the *Re Yagerphone* analysis and conclusions remains valid. Conversely, if the collateral remains subject to the claims of a secured party, the secured party may retain the ability to enforce its rights as against the collateral or any proceeds arising from the collateral.

136 It seems to me that this outcome is consistent with the views of Doyle C.J. in *Fresjac Pty. Ltd. (In liq), Re*, *supra*, which are summarized at [86] - [88] above. I am in agreement with the views and conclusions set out by Doyle C.J. in that case. The outcome is also consistent with the approach of Lee Eng Beng in the emphasized part of [95]. The outcome is also consistent with the approach outlined by Gerald McCormack at [96] and by Nancy Sanborn at [97].

137 Section 95 of the *BIA* makes it clear that a transaction that is declared to be a preference is void as against the trustee. This, in my view, makes it clear that it is the trustee that has the cause of action to declare a preference to be void. But, as stated in *Fresjac Pty. Ltd. (In Lq.)*, *Re supra*, the issue of who possesses the right to bring a preference action does not necessarily determine entitlement to proceeds.

138 The s. 95 cause of action remedy is designed to ensure that there is *pari pasu* treatment as between unsecured creditors. The recipient of a preferential transfer is not entitled to keep the preferential proceeds if the elements of s. 95 are proven. The subject of the preference is returned to the estate but subject to the rights of secured creditors. In the words of Lee Eng Beng at [95] above, "... if a secured creditor has the right to recover the assets transferred away in breach of his security rights and the liquidator or trustee in bankruptcy recovers the assets pursuant to the statutory provisions, any recovery by the latter must be held for the benefit of the former in so far as they would have been recoverable by the secured creditor."

139 Ultimately, distributions of the bankrupt's estate are made pursuant to s. 136 of the *BIA* and again are preferenced with the *proviso*: "subject to the rights of secured creditors".

140 The ability of a trustee to recover monies for the estate for the benefit of creditors is, in its entirety, subject to the rights of secured creditors. If a secured creditor still has rights in the collateral, there is nothing in the fraudulent preference remedy regime that would appear to preclude the secured creditor from exercising its rights. To the extent that the secured party has rights in the collateral and has a remedy against the collateral in the hands of the third party, such remedy and the resulting priority is not, in my view, altered because a trustee embarks on a preference action.

141 This analysis is consistent, in my view, with the structure of the *BIA*. The *BIA* respects the rights of secured creditors. Over time, modifications have been made to the statute to harmonize it with statutes providing for remedies to secured creditors. But, the priority regime has not changed. If the secured creditor has rights to the collateral, the secured creditor takes priority over the claims of unsecured creditors.

142 Counsel to the Trustee also referenced *Re Thorne Ernst & Whinney and Gazzola et al.* in connection with an explanation as to the interplay of the preference provisions and priority distributions. The case involved a dispute between a landlord of a bankrupt tenant and the trustee. The landlord appealed from a judgment holding that a distress levied by the landlord was fraudulent and void as a preference as against the lessee's trustee.

143 Justice Hickson opined that under the *BIA*, the trustee is charged with gathering the assets of the bankrupt for the benefit of the creditors and then distributing those assets pursuant to the scheme of distribution set out in s. 136 of the Act. In the context of a preference, the trustee can bring an application under s. 95 and, if successful, the landlord would be required to pay over the proceeds of the transaction to the trustee. Hickson J.A. went on to state that "in due course, depending on the claims of secured creditors and those standing in priority to the landlord under the scheme of distribution established by s. 136 of the Act, if there are sufficient assets in the estate the landlord will then receive payment pursuant to the provisions of that section".

144 Counsel to the Trustee went on to submit that in a similar case involving a preference action against the landlord, the Court of Appeal for Ontario considered and followed *Gazzola* and, citing concurring reasons in *Gazzola*, the court noted that the preference proceeds are to be distributed in accordance with the scheme in s. 136, which is subject to the rights of secured creditors: See *Canadian Imperial Bank of Commerce v. Canotek Development Corp*., *supra*.

145 In reviewing both the *Gazzola* decision and the *Canotek* decision, I do not see any finding that it is inconsistent with the views that I have expressed above. Simply put, a trustee can pursue a preference action. If the trustee recovers proceeds, they are to be distributed in accordance with s. 136. The reference "which is subject to the rights of secured creditors" restates the position that if secured creditors have rights in the collateral, such priority is to be respected by the trustee.

146 I do not read into the words "subject to the rights of secured creditors" as putting the position of the secured creditor at an even higher level. Specifically, I do not interpret this phrase as enabling a secured party to step into and occupy the position of the trustee. The trustee's rights are established under the *BIA*. The rights of a secured creditor are provided for in security agreements and the *PPSA* and the process by which realization takes place is provided for in court orders, security agreements, the *PPSA*, and in this case, the *BIA*.

147 Counsel to the Trustee also raises a number of policy considerations underlying the *BIA* in support of its position. Specifically, counsel submits that the proposition that unsecured creditors have priority to the proceeds of a preference action may lead to anomalous results insofar as an insolvent person could defeat the rights of a secured creditor by simply granting a preference immediately prior to assigning itself into bankruptcy. The consequences of reversing the preference would be such that the proceeds would benefit unsecured creditors. Counsel submits that it cannot be correct that by dealing with collateral in a preferential fashion, an insolvent person can alter bankruptcy priorities and nullify a secured creditor's exclusive claim to that collateral.

148 This theme has also been recognized in certain academic writings. For example, Professor Fletcher, in *The Law of Insolvency*, provides support for the trustee's position. In stating that the purpose of a preference action is to restore the situation to the *status quo ante*, he puts into doubt the notion that the proceeds of the action are not subject to the rights of secured creditors.

149 The answer to the concern posed by counsel to the Trustee is not easy. To some extent, secured creditors are protected by an ability to take action for recovery as a result of the provisions of their particular security agreement. The *BIA* does not extinguish the rights of secured creditors to follow collateral if circumstances are such that it is lawful and appropriate to follow the collateral.

150 If, for example, the transaction is out of the ordinary course of business or, if the recipient is on notice that it is an improper transaction, the secured party may very well have rights to recover the collateral or proceeds. However, if the debtor was in a position to lawfully dispose of the collateral free and clear of the security interest, and has done so, it could very well be that the only recovery for the secured creditor would be to participate in a distribution to unsecured creditors under s. 136 of the *BIA*. This, of course, would happen if the secured creditor declares part of its indebtedness to be unsecured. This outcome is a consequence, however, not of some realignment or readjustment of priorities under the *BIA*, but rather, it is a consequence of a factual scenario under which the debtor could lawfully transfer the collateral. This outcome is, in my view, consistent with the *Yagerphone* analysis.

151 In the final analysis, I have concluded that:

(i) a trustee in bankruptcy (or a section 38 *BIA* assignee) is the only party that can bring a preference action in bankruptcy proceedings;
(ii) the proceeds recovered by the trustee are brought into the estate;
(iii) distribution under the *BIA* is subject to the rights of recovery of secured creditors;
(iv) the bringing of a preference action and the recovery of proceeds does not preclude secured creditors from pursuing whatever remedies they may have under the provisions of the security agreement and relevant statutes.

152 There is also nothing, in my view, that would preclude a secured creditor from pursuing appropriate remedies in conjunction with the trustee pursuing its remedies. For example, at the outset of a proceeding, when investigations may not have been complete, it may be difficult to pinpoint a specific remedy. This would likely require a cooperative effort as between secured creditors and a trustee and some sort of formal agreement to recognize how matters are to be prosecuted and how proceeds of litigation are to be allocated. An example of such an arrangement is referenced in *Re Sharpland Inc., supra*.

153 Overall, the objective of the preference action is to void preferential transactions for the benefit of creditors, while recognizing legitimate security interests.

154 Air Canada has taken issue with the role of the Trustee in this case and makes specific reference to s. 13.4 of the *BIA* which explicitly contemplates that a trustee may act for or assist a secured creditor in certain circumstances. These submissions from counsel to Air Canada have been put forth in an effort to persuade the court that the Trustee should, in this case, be following the requirements of the *BIA*. Counsel to Air Canada also questions whether this court has the jurisdiction to allow a trustee to pursue a *BIA* preference action within the context of a *CCAA* proceeding.

155 The *CCAA* does address the issue of preferences and transfers under value. Section 36.1(1) provides that the preferential provisions of the *BIA* apply, with any modifications that the circumstances require, in respect of a compromise or arrangement, unless the compromise or arrangement provides otherwise.

156 In this case, there is no compromise or arrangement that has been proposed to creditors, nor is it expected to flow from the type of proceeding that is currently before the court.

157 This leads to a straight-forward conclusion, in my view, that the preference action should proceed under the *BIA*.

158 However, this conclusion leads to the subject of coordination of proceedings under the *CCAA* and the *BIA*. This subject was addressed by the Supreme Court of Canada in *Century Services Inc. v. Canada (Attorney General)*, [2010] 3 S.C.R. 379.

159 In *Century Services*, the majority noted that the *CCAA* is a flexible statute designed to preserve the value of a business as a going-concern through a court supervised re-organization. In that case, a re-organization under the *CCAA* had failed and the Crown brought a motion for payment of its statutory deemed trusts pursuant to s. 222(3) of the *Excise Tax Act*, R.S.C. 1985, c. E-15. Brenner C.J. denied the motion and allowed the assignment of the company into bankruptcy. The British Columbia Court of Appeal had found that while the Crown could not seek repayment of GST source deductions in priority to other claims during a *CCAA* or *BIA* proceeding, it could do so after the reorganization efforts had failed and prior to the commencement of a *BIA* proceeding, such that the trial judge was bound to allow the motion and apply the provisions of the *Excise Tax Act*. The majority of the Supreme Court rejected this reasoning noting at para. 47 that an interpretation giving the *Excise Tax Act* priority over the *CCAA* would result in a "strange asymmetry" which would encourage statute shopping.

160 Justice Deschamps, writing for the majority, rejected the contention that Brenner C.J. had exceeded his authority by continuing the stay of the Crown's GST claims while temporarily lifting the general stay to allow for the assignment in bankruptcy. Section 11 of the *CCAA*, subject to certain restrictions, provides the court with broad authority to make an order that is appropriate in the circumstances - a power which is not subject to explicit temporal limitations and is buttressed by the court's inherent jurisdiction, as well as s. 20 (now s. 42) of the *CCAA*.

161 At para. 76 of *Century Services,* it is noted that the *CCAA*'s objectives permit for a bridge between the *CCAA* and *BIA* proceedings. As recently noted by the Supreme Court of Canada regarding section 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*.

162 Further, Deschamps J. wrote at para. 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.

163 This passage from *Century Services* clearly states, in my view, that the courts should be taking a pragmatic approach in determining issues which arise in proceedings where the *CCAA* overlaps with the *BIA*. This is one such proceeding. The overall objective should be to create a system under which the court can review transactions entered into between the debtor and creditors in the period just prior to formal insolvency proceedings. The policy should be to ensure that there is an appropriate review mechanism in place to challenge transactions that are not consistent with ordinary course activities and have had the effect of unfairly transferring value to a third party during the review period. It seems to me that the *CCAA* can operate in tandem with the *BIA* in an effort to return matters to the *status quo*.

164 Applying the principles of *Century Services*, it seems to me, that the preference motion should proceed in the *BIA* proceedings. However, in my view, this can be accomplished by a procedural order in *CCAA* proceedings which transitions the matter to the *BIA*. There is no necessity or principled reasons to require the trustee to start from square one. This outcome is consistent with

my endorsement of February 24, 2010 at paras. 29-32.

165 It is also appropriate, at this time, and in view of the contemplated continuation of the preference motion, that proceedings be regularized with the Trustee taking the necessary steps to comply with its obligation under the *BIA*.

DISPOSITION

166 In the result, a declaration shall issue to incorporate the conclusions set out at [151] which, for ease of reference, is repeated:

> (i) a trustee in bankruptcy (or a Section 38 *BIA* assignee) is the only party that can bring a preference action in bankruptcy proceedings;
> (ii) the proceeds recovered by the trustee are brought into the estate;
> (iii) distribution under the *BIA* is subject to the rights of recovery of secured creditors;
> (iv) the bringing of a preference action and the recovery of proceeds does not preclude secured creditors from pursuing whatever remedies they may have under the provisions of the security agreement and relevant statutes.

167 I have also concluded that, if it is determined that the transaction is void as being a preference, at that point, the appropriate determination can be made as to which party, be it either the trustee or the secured party, is entitled to the proceeds. This determination should be based on whether the secured party has the right to recover the assets transferred, or any proceeds resulting from such transfer. In my view, it is premature to comment on this issue, in the circumstances of this case, as the factual record has not been fully determined.

168 In the context of this particular case, if it is the intention of the secured party to work in conjunction with the Trustee and for the Trustee to utilize the preference provisions, the appropriate notifications should be provided in accordance with s. 13.4 of the *BIA* and the Trustee should move forward to fulfill its statutory obligations in the conduct of its administration.

169 To the extent that further directions are required in respect of this endorsement, the parties may contact the Commercial List Office to set up a 9:30 a.m. appointment.

G.B. MORAWETZ J.

TAB 4

Indexed as:

Century Services Inc. v. Canada (Attorney General)

Century Services Inc. Appellant;
v.
Attorney General of Canada on behalf of Her Majesty The Queen in Right of Canada Respondent.

[2010] 3 S.C.R. 379

[2010] 3 R.C.S. 379

[2010] S.C.J. No. 60

[2010] A.C.S. no 60

2010 SCC 60

2010 CarswellBC 3419

72 C.B.R. (5th) 170

12 B.C.L.R. (5th) 1

296 B.C.A.C. 1

326 D.L.R. (4th) 577

409 N.R. 201

[2011] 2 W.W.R. 383

File No.: 33239.

Supreme Court of Canada

Heard: May 11, 2010;
Judgment: December 16, 2010.

Present: McLachlin C.J. and Binnie, LeBel, Deschamps, Fish,

Abella, Charron, Rothstein and Cromwell JJ.

(136 paras.)

Appeal From:

ON APPEAL FROM THE COURT OF APPEAL FOR BRITISH COLUMBIA

Catchwords:

Bankruptcy and Insolvency -- Priorities -- Crown applying on eve of bankruptcy of debtor company to have GST monies held in trust paid to Receiver General of Canada -- Whether deemed trust in favour of Crown under Excise Tax Act prevails over provisions of Companies' Creditors Arrangement Act purporting to nullify deemed trusts in favour of Crown -- Companies' Creditors Arrangement Act, R.S.C. 1985, c. C-36, s. 18.3(1) -- Excise Tax Act, R.S.C. 1985, c. E-15, s. 222(3).

Bankruptcy and insolvency -- Procedure -- Whether chambers judge had authority to make order partially lifting stay of proceedings to allow debtor company to make assignment in bankruptcy and to stay Crown's right to enforce GST deemed trust -- Companies' Creditors Arrangement Act, R.S.C. 1985, c. C-36, s. 11.

Trusts -- Express trusts -- GST collected but unremitted to Crown -- Judge ordering that GST be held by Monitor in trust account -- Whether segregation of Crown's GST claim in Monitor's account created an express trust in favour of Crown.

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Summary:

The debtor company commenced proceedings under the *Companies' Creditors Arrangement Act* ("*CCAA*"), obtaining a stay of proceedings to allow it time to reorganize its financial affairs. One of the debtor company's outstanding debts at the commencement of the reorganization was an amount of unremitted Goods and Services Tax ("GST") payable to the Crown. Section 222(3) of the *Excise Tax Act* ("*ETA*") created a deemed trust over unremitted GST, which operated despite any other enactment of Canada except the *Bankruptcy and Insolvency Act* ("*BIA*"). However, s. 18.3(1) of the *CCAA* provided that any statutory deemed trusts in favour of the Crown did not operate under the *CCAA*, subject to certain exceptions, none of which mentioned GST.

Pursuant to an order of the *CCAA* chambers judge, a payment not exceeding $5 million was approved to the debtor company's major secured creditor, Century Services. However, the chambers judge also ordered the debtor company to hold back and segregate in the Monitor's trust account an amount equal to the unremitted GST pending the outcome of the reorganization. On concluding that

reorganization was not possible, the debtor company sought leave of the court to partially lift the stay of proceedings so it could make an assignment in bankruptcy under the *BIA*. The Crown moved for immediate payment of unremitted GST to the Receiver General. The chambers judge denied the Crown's motion, and allowed the assignment in bankruptcy. The Court of Appeal allowed the appeal on two grounds. First, it reasoned that once reorganization efforts had failed, the chambers judge was bound under the priority scheme provided by the *ETA* to allow payment of unremitted GST to the Crown and had no discretion under s. 11 of the *CCAA* to continue the stay against the Crown's claim. Second, the Court of Appeal concluded that by ordering the GST funds segregated in the Monitor's trust account, the chambers judge had created an express trust in favour of the Crown.

Held (Abella J. dissenting): The appeal should be allowed.

Per McLachlin C.J. and Binnie, LeBel, Deschamps, Charron, Rothstein and Cromwell JJ.: The apparent conflict between s. 222(3) of the *ETA* and s. 18.3(1) of the *CCAA* can be resolved through an interpretation that properly recognizes the history of the *CCAA*, its function amidst the body of insolvency legislation enacted by [page381] Parliament and the principles for interpreting the *CCAA* that have been recognized in the jurisprudence. The history of the *CCAA* distinguishes it from the *BIA* because although these statutes share the same remedial purpose of avoiding the social and economic costs of liquidating a debtor's assets, the *CCAA* offers more flexibility and greater judicial discretion than the rules-based mechanism under the *BIA*, making the former more responsive to complex reorganizations. Because the *CCAA* is silent on what happens if reorganization fails, the *BIA* scheme of liquidation and distribution necessarily provides the backdrop against which creditors assess their priority in the event of bankruptcy. The contemporary thrust of legislative reform has been towards harmonizing aspects of insolvency law common to the *CCAA* and the *BIA*, and one of its important features has been a cutback in Crown priorities. Accordingly, the *CCAA* and the *BIA* both contain provisions nullifying statutory deemed trusts in favour of the Crown, and both contain explicit exceptions exempting source deductions deemed trusts from this general rule. Meanwhile, both Acts are harmonious in treating other Crown claims as unsecured. No such clear and express language exists in those Acts carving out an exception for GST claims.

When faced with the apparent conflict between s. 222(3) of the *ETA* and s. 18.3(1) of the *CCAA*, courts have been inclined to follow *Ottawa Senators Hockey Club Corp. (Re)* and resolve the conflict in favour of the *ETA*. *Ottawa Senators* should not be followed. Rather, the *CCAA* provides the rule. Section 222(3) of the *ETA* evinces no explicit intention of Parliament to repeal *CCAA* s. 18.3. 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 expressly and elaborately. Meanwhile, there is no express statutory basis for concluding that GST claims enjoy a preferred treatment under the *CCAA* or the *BIA*. The internal logic of the *CCAA* appears to subject a GST deemed trust to the waiver by Parliament of its priority. A strange asymmetry would result if differing treatments of GST deemed trusts under the *CCAA* and the *BIA* were found to exist, as this would encourage statute shopping, undermine the *CCAA*'s remedial purpose and invite the very

social ills that the statute was enacted to avert. The later in time enactment of the more general s. 222(3) of the *ETA* does not require application of the doctrine of implied repeal to the earlier and more specific s. 18.3(1) of the *CCAA* in the circumstances of this case. In any event, [page382] recent amendments to the *CCAA* in 2005 resulted in s. 18.3 of the Act being renumbered and reformulated, making it the later in time provision. This confirms that Parliament's intent with respect to GST deemed trusts is to be found in the *CCAA*. The conflict between the *ETA* and the *CCAA* is more apparent than real.

The exercise of judicial discretion has allowed the *CCAA* to adapt and evolve to meet contemporary business and social needs. As reorganizations become increasingly complex, *CCAA* courts have been called upon to innovate. In determining their jurisdiction to sanction measures in a *CCAA* proceeding, courts should first interpret the provisions of the *CCAA* before turning to their inherent or equitable jurisdiction. Noteworthy in this regard is the expansive interpretation the language of the *CCAA* is capable of supporting. The general language of the *CCAA* should not be read as being restricted by the availability of more specific orders. The requirements of appropriateness, good faith and due diligence are baseline considerations that a court should always bear in mind when exercising *CCAA* authority. The question is whether the order will usefully further efforts to avoid the social and economic losses resulting from liquidation of an insolvent company, which extends to both the purpose of the order and the means it employs. Here, the chambers judge's order staying the Crown's GST claim was in furtherance of the *CCAA*'s objectives because it blunted the impulse of creditors to interfere in an orderly liquidation and fostered a harmonious transition from the *CCAA* to the *BIA*, meeting the objective of a single proceeding that is common to both statutes. 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 *BIA* proceedings, but no gap exists between the two statutes because they operate in tandem and creditors in both cases look to the *BIA* scheme of distribution to foreshadow how they will fare if the reorganization is unsuccessful. The breadth of the court's discretion under the *CCAA* is sufficient to construct a bridge to liquidation under the *BIA*. Hence, the chambers judge's order was authorized.

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No express trust was created by the chambers judge's order in this case because there is no certainty of object inferrable from his order. Creation of an express trust requires certainty of intention, subject matter and object. At the time the chambers judge accepted the proposal to segregate the monies in the Monitor's trust account there was no certainty that the Crown would be the beneficiary, or object, of the trust because exactly who might take the money in the final result was in doubt. In any event, no dispute over the money would even arise under the interpretation of s. 18.3(1) of the *CCAA* established above, 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.

Per Fish J.: The GST monies collected by the debtor are not subject to a deemed trust or priority in favour of the Crown. In recent years, Parliament has given detailed consideration to the Canadian

insolvency scheme but has declined to amend the provisions at issue in this case, a deliberate exercise of legislative discretion. On the other hand, in upholding deemed trusts created by the *ETA* notwithstanding insolvency proceedings, courts have been unduly protective of Crown interests which Parliament itself has chosen to subordinate to competing prioritized claims. In the context of the Canadian insolvency regime, deemed trusts exist only where there is a statutory provision creating the trust and a *CCAA* or *BIA* provision explicitly confirming its effective operation. The *Income Tax Act*, the *Canada Pension Plan* and the *Employment Insurance Act* all contain deemed trust provisions that are strikingly similar to that in s. 222 of the *ETA* but they are all also confirmed in s. 37 of the *CCAA* and in s. 67(3) of the *BIA* in clear and unmistakeable terms. The same is not true of the deemed trust created under the *ETA*. Although Parliament created 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 did not confirm the continued operation of the trust in either the *BIA* or the *CCAA*, reflecting Parliament's intention to allow the deemed trust to lapse with the commencement of insolvency proceedings.

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Per Abella J. (dissenting): Section 222(3) of the *ETA* gives priority during *CCAA* proceedings to the Crown's deemed trust in unremitted GST. This provision unequivocally defines its boundaries in the clearest possible terms and excludes only the *BIA* from its legislative grasp. The language used reflects a clear legislative intention that s. 222(3) would prevail if in conflict with any other law except the *BIA*. This is borne out by the fact that following the enactment of s. 222(3), amendments to the *CCAA* were introduced, and despite requests from various constituencies, s. 18.3(1) was not amended to make the priorities in the *CCAA* consistent with those in the *BIA*. This indicates a deliberate legislative choice to protect the deemed trust in s. 222(3) from the reach of s. 18.3(1) of the *CCAA*.

The application of other principles of interpretation reinforces this conclusion. An earlier, specific provision may be overruled by a subsequent general statute if the legislature indicates, through its language, an intention that the general provision prevails. Section 222(3) achieves this 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). By operation of s. 44(*f*) of the *Interpretation Act*, the transformation of s. 18.3(1) into s. 37(1) after the enactment of s. 222(3) of the *ETA* has no effect on the interpretive queue, and s. 222(3) of the *ETA* remains the "later in time" provision. This means that the deemed trust provision in s. 222(3) of the *ETA* takes precedence over s. 18.3(1) during *CCAA* proceedings. While s. 11 gives a court discretion to make orders notwithstanding the *BIA* and the *Winding-up Act*, 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.

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Cases Cited

By Deschamps J.

Overruled: *Ottawa Senators Hockey Club Corp. (Re)* (2005), 73 O.R. (3d) 737; **distinguished:** *Doré v. Verdun (City)*, [1997] 2 S.C.R. 862; **referred to:** *Reference re Companies' Creditors Arrangement Act*, [1934] S.C.R. 659; *Quebec (Revenue) v. Caisse populaire Desjardins de Montmagny*, 2009 SCC 49, [2009] 3 S.C.R. 286; *Deputy Minister of Revenue v. Rainville*, [1980] 1 S.C.R. 35; *Gauntlet Energy Corp., Re*, 2003 ABQB 894, 30 Alta. L.R. (4) 192; *Komunik Corp. (Arrangement relatif à)*, 2009 QCCS 6332 (CanLII), leave to appeal granted, 2010 QCCA 183 (CanLII); *Royal Bank of Canada v. Sparrow Electric Corp.*, [1997] 1 S.C.R. 411; *First Vancouver Finance v. M.N.R.*, 2002 SCC 49, [2002] 2 S.C.R. 720; *Solid Resources Ltd., Re* (2002), 40 C.B.R. (4) 219; *Metcalfe & Mansfield Alternative Investments II Corp. (Re)*, 2008 ONCA 587, 92 O.R. (3d) 513; *Dylex Ltd., Re* (1995), 31 C.B.R. (3d) 106; *Elan Corp. v. Comiskey* (1990), 41 O.A.C. 282; *Chef Ready Foods Ltd. v. Hongkong Bank of Can.* (1990), 51 B.C.L.R. (2d) 84; *Pacific National Lease Holding Corp., Re* (1992), 19 B.C.A.C. 134; *Canadian Airlines Corp., Re*, 2000 ABQB 442, 84 Alta. L.R. (3d) 9; *Air Canada, Re* (2003), 42 C.B.R. (4) 173; *Air Canada, Re*, 2003 CanLII 49366; *Canadian Red Cross Society/Société Canadienne de la Croix Rouge, Re* (2000), 19 C.B.R. (4) 158; *Skydome Corp., Re* (1998), 16 C.B.R. (4) 118; *United Used Auto & Truck Parts Ltd., Re*, 2000 BCCA 146, 135 B.C.A.C. 96, aff'g (1999), 12 C.B.R. (4) 144; *Skeena Cellulose Inc., Re*, 2003 BCCA 344, 13 B.C.L.R. (4) 236; *Stelco Inc. (Re)* (2005), 75 O.R. (3d) 5; *Philip's Manufacturing Ltd., Re* (1992), 9 C.B.R. (3d) 25; *Ivaco Inc. (Re)* (2006), 83 O.R. (3d) 108.

By Fish J.

Referred to: *Ottawa Senators Hockey Club Corp. (Re)* (2005), 73 O.R. (3d) 737.

By Abella J. (dissenting)

Ottawa Senators Hockey Club Corp. (Re) (2005), 73 O.R. (3d) 737; *Tele-Mobile Co. v. Ontario*, 2008 SCC 12, [2008] 1 S.C.R. 305; *Doré v. Verdun (City)*, [1997] 2 S.C.R. 862; *Attorney General of Canada v. Public Service Staff Relations Board*, [1977] 2 F.C. 663.

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1997, c. 12, s. 73; 2000, c. 30, s. 148; 2005, c. 47, s. 69; 2009, c. 33, s. 25].

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History and Disposition:

APPEAL from a judgment of the British Columbia Court of Appeal (Newbury, Tysoe and Smith JJ.A.), 2009 BCCA 205, 98 B.C.L.R. (4) 242, 270 B.C.A.C. 167, 454 W.A.C. 167, [2009] 12 W.W.R. 684, [2009] G.S.T.C. 79, [2009] B.C.J. No. 918 (QL), 2009 CarswellBC 1195, reversing a judgment of Brenner C.J.S.C., 2008 BCSC 1805, [2008] G.S.T.C. 221, [2008] B.C.J. No. 2611 (QL), 2008 CarswellBC 2895, dismissing a Crown application for payment of GST monies. Appeal allowed, Abella J. dissenting.

Counsel:

Mary I. A. Buttery, *Owen J. James* and *Matthew J. G. Curtis*, for the appellant.

Gordon Bourgard, *David Jacyk* and *Michael J. Lema*, for the respondent.

The judgment of McLachlin C.J. and Binnie, LeBel, Deschamps, Charron, Rothstein and Cromwell JJ. was delivered by

1 DESCHAMPS J.:-- 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 [page389] 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.

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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).

6 The Crown's appeal was allowed by the British Columbia Court of Appeal (2009 BCCA 205, 270 B.C.A.C. 167). 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 [page391] 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), 73 O.R. (3d) 737 (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. <u>Issues</u>

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?

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3. <u>Analysis</u>

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 [page393] 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 [page394] 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 [page395] Arrangement Act*, [1934] S.C.R. 659, 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 [page396] 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, 3rd Sess., 34th Parl., October 3, 1991, at 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 [page397] 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, [page398] 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, s. 25; see also *Quebec (Revenue) v. Caisse populaire Desjardins de Montmagny*, 2009 SCC 49, [2009] 3 S.C.R. 286; *Deputy Minister of Revenue v. Rainville*, [1980] 1 S.C.R. 35; *Proposed Bankruptcy Act Amendments: Report of the Advisory Committee on Bankruptcy and Insolvency*).

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, 30 Alta. L.R. (4th) 192, at para. 19).

25 Mindful of the historical background of the *CCAA* and *BIA*, I now turn to the first question at issue.

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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. (Arrangement relatif à)*, 2009 QCCS 6332 (CanLII), leave to appeal granted, 2010 QCCA 183 (CanLII)). 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 [page400] 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 added 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. Bankr. 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 s.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 [page401] 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 of Canada v. Sparrow Electric Corp.*, [1997] 1 S.C.R. 411, 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. M.N.R.*, 2002 SCC 49, [2002] 2 S.C.R. 720, 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").

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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, [page403] 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.

[page404]

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 [page405] 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 (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 v. Verdun (City)*, [1997] 2 S.C.R. 862, 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, [page406] 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 [page407] 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.

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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*.

[page409]

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 [page410] 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 [page411] 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.

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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" (*Metcalfe & Mansfield Alternative Investments II Corp. (Re)*, 2008 ONCA 587, 92 O.R. (3d) 513, 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. Ct. (Gen. Div.)), 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.

(*Elan Corp. v. Comiskey* (1990), 41 O.A.C. 282
, 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 [page413] 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., *Chef Ready Foods Ltd. v. Hongkong Bank of Can.* (1990), 51 B.C.L.R. (2d) 84 (C.A.), at pp. 88-89; *Pacific National Lease Holding Corp., Re* (1992), 19 B.C.A.C. 134, 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, at para. 144, *per* Paperny J. (as she then was); *Air Canada, Re* (2003), 42 C.B.R. (4th) 173 (Ont. S.C.J.), at para. 3; *Air Canada, Re*, 2003 CanLII 49366 (Ont. S.C.J.), 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.

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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. Ct. (Gen. Div.)); *United Used Auto & Truck Parts Ltd., Re*, 2000 BCCA 146, 135 B.C.A.C. 96, aff'g (1999), 12 C.B.R. (4th) 144 (S.C.); 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 [page415] 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, at paras. 45-47, *per* Newbury J.A.; *Stelco Inc. (Re)* (2005), 75 O.R. (3d) 5 (C.A.), at 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 [page416] 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 [page417] 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*.

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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 [page419] 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 [page420] lost in bankruptcy (*Ivaco Inc. (Re)* (2006), 83 O.R. (3d) 108, 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 [page421] 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.

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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 [page423] 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.

The following are the reasons delivered by

FISH J. --

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*"). [page424] 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).

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 (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.

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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:

> (4) 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) 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
>
> (*a*) to be held, from the time the amount was deducted or withheld by the person, separate and [page426] apart from the property of the person, in trust for Her Majesty whether or not the property is subject to such a security interest, ...
>
> ...
>
> ... 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 held in trust for Her Majesty unless it would be so regarded in the absence of that statutory provision.

> (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*:

> (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.

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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) of the *CCAA* and in s. 67(3) of 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) 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 [page428] security interest, would be property of the person, until the amount is remitted to the Receiver General or withdrawn under subsection (2).
>
> ...
>
> (3) Despite any other provision of this Act (except subsection (4)), any other enactment of Canada (except the *Bankruptcy and InsolvencyAct*), 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 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, at para. 37). *All* of the deemed trust [page429] 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 [page430] be subject to no deemed trust or priority in favour of the Crown.

The following are the reasons delivered by

114 ABELLA J. (dissenting):-- The central issue in this appeal is whether s. 222 of the *Excise Tax Act*, R.S.C. 1985, c. E-15 ("*ETA*"), 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:

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> (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
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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
>
> (*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 (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 [page432] 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 [page433] 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). 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 *Tele-Mobile Co. v. Ontario*, 2008 SCC 12, [2008] 1 S.C.R. 305, 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]

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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 derogant*).

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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 v. Verdun (City)*, [1997] 2 S.C.R. 862).

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:

> ... the 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 [page436] 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 *Attorney General of Canada v. Public Service Staff Relations Board*, [1977] 2 F.C. 663, dealing with the predecessor provision to s. 44(*f*)). It directs that new enactments not be construed as [page437] "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 re-order the provisions of this Act". During second reading, the Hon. Bill Rompkey, then the Deputy Leader of the Government in the [page438] 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.
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> (*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 [page439] 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.

* * * * *

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 (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.

(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,

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(*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,

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(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, [page442] 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 [page443] 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 [page444] 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.

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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 [page446] 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*);

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(*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 [page448] 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 [page449] 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 [page450] 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.

[page451]

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) [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 [page452] 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

[page453]

(*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

[page454]

(*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

[page455]

(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.

Appeal allowed with costs, ABELLA J. *dissenting.*

Solicitors:

Solicitors for the appellant: Fraser Milner Casgrain, Vancouver.

Solicitor for the respondent: Attorney General of Canada, Vancouver.

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.

TAB 5

Case Name:

Ernst & Young Inc. v. Essar Global Fund Ltd.

Between
Ernst & Young Inc. in its capacity as Monitor of all of the following: Essar Steel Algoma Inc., Essar Tech Algoma Inc., Algoma Holdings B.V., Essar Steel Algoma (Alberta) ULC, Cannelton Iron Ore Company and Essar Steel Algoma Inc. USA, Plaintiff (Respondent), and Essar Global Fund Limited, Essar Power Canada Ltd., New Trinity Coal, Inc., Essar Ports Algoma Holding Inc., Algoma Port Holding Company Inc., Port of Algoma Inc., Essar Steel Limited and Essar Steel Algoma Inc., Defendants (Appellants/Respondent)

[2017] O.J. No. 6723

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420 D.L.R. (4th) 23

2017 CarswellOnt 20162

286 A.C.W.S. (3d) 658

54 C.B.R. (6th) 173

139 O.R. (3d) 1

Dockets: C63581, C63588

Ontario Court of Appeal

R.A. Blair, S.E. Pepall and K.M. van Rensburg JJ.A.

Heard: August 15-17, 2017.
Judgment: December 21, 2017.

(259 paras.)

Bankruptcy and insolvency law -- Companies' Creditors Arrangement Act (CCAA) matters -- Compromises and arrangements -- Monitors -- Powers, duties, and functions -- Appeal by defendants from trial judgment granting respondent Algoma remedy for oppression dismissed -- Supervising CCAA judge authorized court-appointed Monitor during restructuring proceedings of Algoma Inc. to commence action for oppression against Algoma's parent, the Essar appellants -- Monitor had standing to bring an oppression claim -- Monitor took the action as an adjunct to its role in facilitating a restructuring -- There was prima facie evidence of personal harm to the pensioners, employees, retirees, and trade creditors of Algoma.

Corporations, partnerships and associations law -- Corporations -- Oppression remedy -- Standing -- Complainant -- Grounds -- Conduct that unfairly disregards the interest of any security holder, creditor, director or officer -- Powers of the court -- Varying a transaction -- Appeal by defendants from trial judgment granting respondent Algoma remedy for oppression dismissed -- Action arose in context of recapitalization of Algoma and a transaction between Algoma and Portco, two companies indirectly owned by Essar Global, in which Algoma's port facilities were conveyed to Portco which effectively provided Portco with ability to veto any change in control of Algoma's business -- Trial judge did not err in his analysis of reasonable expectations -- Trial judge's conclusion that Essar Global's conduct was wrongful and harmful was supported by the evidence.

Appeal by the defendants from trial judgment granting the respondent a remedy for oppression. Ernst & Young was the court-appointed Monitor during the restructuring proceedings of the respondent Algoma Inc. under the Companies' Creditors Arrangement Act (CCAA). The supervising CCAA judge authorized the Monitor to commence an action for oppression against Algoma's parent, the Essar appellants. The action arose in the context of a recapitalization of Algoma and a transaction between Algoma and Portco, two companies indirectly owned by Essar Global, in which Algoma's port facilities were conveyed to Portco in 2014. The outcome of the Port Transaction was that all Port assets were transferred from Algoma to Portco, the Port lands were leased to Portco for 50 years, and Portco obtained change of control rights. The Port Transaction effectively provided Portco with the ability to veto any change in control of Algoma's business. The appellants GIP were arm's length lenders who loaned Portco US$150 million to effect the transaction. The Monitor alleged that the Essar Group had exercised de facto control over Algoma and had engaged in a course of conduct that consistently preferred the interests of the Essar Group to those of Algoma and its stakeholders. The oppression occasioned was exacerbated by the fact that the borrowed monies raised through the Port Transaction were a substitution for monies Essar Global had promised to contribute as equity in Algoma. The trial judge held that the reasonable expectations of the trade creditors, employees, pensioners, and retirees were violated by the Port

Transaction itself and the change of control veto provided to Portco, and thus Essar Global, in the Port Transaction. He concluded that the Port Transaction was itself unfairly prejudicial to, and unfairly disregarded, the interests of Algoma's trade creditors, employees, pensioners, and retirees. He found the change of control clause in the Cargo Handling Agreement gave Essar Global control over who could be a buyer of the Algoma business was oppressive and also harmful to the restructuring process. He found that Essar Global received an unreasonable benefit from the Port Transaction and that it was an exercise in self-dealing. The appellants argued that the Monitor lacked standing to bring an oppression claim and that the alleged harm was to Algoma and that therefore the appropriate redress was a derivative action.

HELD: Appeal dismissed. The Monitor took the action as an adjunct to its role in facilitating a restructuring and proceeded with the oppression action in the interests of the restructuring consistent with the objectives of the CCAA. A prima facie case had been established for the Monitor to commence an oppression claim. At law, the Monitor was at liberty to bring an action for oppression. There was prima facie evidence of personal harm to the pensioners, employees, retirees, and trade creditors. The court and the Monitor were faced with prima facie evidence of oppression, including bad faith and self-dealing. The trial judge did not err in his analysis of reasonable expectations. He considered both subjective expectations and whether the expectations were objectively reasonable. The trial judge's conclusion that Essar Global's conduct was wrongful and harmful was supported by the evidence. Essar Global's conduct created a situation where Algoma had no choice but to accept the Port Transaction. There was no palpable and overriding error in the trial judge's understanding of the recapitalization requirements or in the trial judge's conclusion that Algoma's Board was precluded from relying on the business judgment rule. The trial judge did not err in striking out the control clause in the Cargo Handling Agreement and in granting Algoma the option of terminating the Port agreements upon repayment of the GIP loan.

Statutes, Regulations and Rules Cited:

Bankruptcy and Insolvency Act, R.S.C. 1985, c. B-3,

Canada Business Corporations Act, R.S.C. 1985, c. C-44, s. 192, s. 238, s. 238(d), s. 239, s. 241, s. 241(3)

Companies' Creditors Arrangement Act, R.S.C. 1985, c. C-36, s. 11, s. 11.7(1), s. 23, s. 23(1)(c), s. 23(1)(k)

Appeal From:

On appeal from the judgment of Justice Frank Newbould of the Superior Court of Justice, dated March 15, 2017, with reasons reported at 2017 ONSC 1366, 137 O.R. (3d) 438 and from the costs order, dated June 29, 2017, with reasons reported at 2017 ONSC 4017, 50 C.B.R. (6th) 148.

Counsel:

Patricia D.S. Jackson, Andrew D. Gray, Jeremy Opolsky, Alexandra Shelley and Davida Shiff, for the appellants Essar Global Fund Limited, New Trinity Coal, Inc., Essar Ports Algoma Holding Inc., Essar Ports Canada Holding Inc., Algoma Port Holding Company Inc., Port of Algoma Inc., and Essar Steel Limited.

Clifton P. Prophet, Nicholas Kluge and Delna Contractor, for the respondent Ernst & Young Inc. in its capacity as Monitor of Essar Steel Algoma Inc. et al.

Eliot N. Kolers and Patrick Corney, for the respondent Essar Steel Algoma Inc.

Peter H. Griffin, Monique Jilesen and Kim Nusbaum, for the appellants GIP Primus, L.P. and Brightwood Loan Services LLC.

The judgment of the Court was delivered by

1 S.E. PEPALL J.A.:-- This appeal concerns a successful oppression action brought pursuant to s. 241 of the *Canada Business Corporations Act*, R.S.C. 1985, c. C-44 (the "*CBCA*"). It involves the *Companies' Creditors Arrangement Act*, R.S.C. 1985, c. C-36 (the "*CCAA*") restructuring proceedings of the respondent, Essar Steel Algoma Inc. ("Algoma")[1], one of Canada's largest integrated steel mills and the respondent, Ernst & Young Inc., the court-appointed Monitor.

2 The supervising *CCAA* judge authorized the Monitor to commence an action for oppression against Algoma's parent, the appellant Essar Global Fund Limited ("Essar Global"), and the remaining appellants, other companies owned directly or indirectly by Essar Global (the "Essar Group"). The action arose in the context of a recapitalization of Algoma and a transaction between Algoma and Port of Algoma Inc. ("Portco"), two companies indirectly owned by Essar Global, in which Algoma's port facilities in Sault Ste. Marie (the "Port") were conveyed to Portco.

3 Portco is a single purpose company established by Essar Global. As Portco's name suggests, it currently controls the Sault Ste. Marie Port. Portco obtained control in November 2014 in a transaction between Algoma, Portco, and Essar Global (the "Port Transaction"). The Port Transaction effectively provided Portco with the ability to veto any change in control of Algoma's business. The interveners below and appellants on appeal, GIP Primus, L.P. and Brightwood Loan Services LLC (collectively "GIP"), are arm's length lenders who loaned Portco US$150 million to effect the transaction.

4 The trial judge found the Port Transaction and other conduct of Essar Global to be oppressive and granted a remedy that was designed to address that oppression. Essar Global and some of the

members of the Essar Group, together with GIP, appeal from that judgment. The appellants advance a number of arguments, many of them factual, in support of their appeal. The appellants' two principal legal submissions are first, that the Monitor lacked standing to bring an oppression claim and second, that the alleged harm was to Algoma and that therefore the appropriate redress was a derivative action.

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

A. FACTS

(1) Algoma's Operations

6 The City of Sault Ste. Marie sits on the shore of St. Mary's River, a waterway that links Lake Superior to Lake Huron at the heart of the Great Lakes, close to the Canada/U.S. border. The steel production operations that are owned by Algoma have been the primary employer and economic engine of the City since construction of the steel mill in 1901. Not surprisingly, the City's Port, which is situated next to Algoma's buildings and facilities, is integral to the steel operations. Indeed, Algoma is the Port's primary customer and its employees have traditionally run the Port operations. Raw materials used to produce steel are shipped to the Port and the steel that is produced is shipped to market from the Port. The relationship is one of mutual dependence.

7 Unfortunately, Algoma was in and out of *CCAA* protection proceedings both in 1991 and in 2001. In late 2013, Algoma faced another liquidity crisis and restructured under the *CBCA* in 2014. The recent *CCAA* filing occurred on November 9, 2015.

(2) The Essar Group

8 Essar Global is a Cayman Islands limited liability company and the ultimate parent of the respondent Algoma, which it acquired through its subsidiaries in 2007. Essar Global is also the parent of the appellants Portco, Essar Power Canada Ltd., New Trinity Coal Inc., Essar Ports Algoma Holding Inc., Algoma Port Holding Company Inc., and Essar Steel Limited. Its investments are managed by Essar Capital Limited ("Essar Capital"), which is based in London, England. These companies are part of the Essar Group, a multinational conglomerate that was founded in India by two brothers, Sashi and Ravi Ruia. Members of the Ruia family are the beneficial owners of the Essar Group.

(3) Algoma's Recapitalization

9 In late 2013, Algoma was facing a liquidity crisis. Algoma anticipated being unable to meet a coupon payment due to unsecured bondholders in June 2014, and its US$346 million term loan was to mature in September 2014. Although Essar Global had been injecting substantial funds into Algoma, it was hesitant to advance further cash to Algoma. Algoma decided to consider mechanisms to restructure and reduce its debt and therefore embarked on a recapitalization project.

10 At the time of the discussions relating to the recapitalization, Algoma's Board of Directors consisted of five appointees affiliated with the Ruia family or the Essar Group, and three independent directors. In early January 2014, the Board of Directors placed responsibility for Algoma's recapitalization efforts in the hands of Essar Global and Essar Capital employees. Algoma personnel had no day-to-day control over the recapitalization project.

11 Although the three independent directors had begun expressing concerns about their roles on the Board as early as the fall of 2013, in the face of Algoma's serious financial challenges, their concerns became more acute. Specifically, they were concerned that their requests for timely, full disclosure of information and full participation in the strategic decisions of the Board had not been properly taken into account by the other Board members. On January 19, 2014, the three sent a memo to the Board proposing the establishment of an independent committee to work with outside financial advisors to evaluate options and alternatives for Algoma's recapitalization. The Board held a meeting on February 11, 2014, and rejected this proposal by a vote of four to three, the three being the independent directors. In response, one of the three independent directors resigned. The other two initially remained on the Board.

12 On February 17, 2014, one of the remaining independent directors, Thomas Dodds, wrote to Prashant Ruia seeking a meeting. Prashant Ruia was then the vice-chair of Algoma's Board, the son of one of the founders of Essar Group, and a director of Essar Capital. Mr. Dodds wrote:

> If your expectation of [the Algoma] Board is to simply be a formality and our role as independent directors is to essentially "rubberstamp" shareholder and management decisions, we are not prepared to continue serving as directors.
>
> As you know, Directors and particularly independent directors have a legal, fiduciary responsibility to all the stakeholders of the Company starting with the Company first, followed by the shareholders, employees, community and others. This Director responsibility may on occasion conflict with the objectives of the shareholder who may, understandably, be more interested in matters of import to themselves. Most of the time there will be no conflict between the responsibilities of the Directors, objectives of the shareholder and that of the Company stakeholders as broadly defined. However, there are other occasions when they do.
>
> What we as independent directors have experienced in the last few Board meetings is a complete disregard for any discussion or wholesome debate on alternatives to re-financing or contingency planning at [Algoma].

...

> In addition when we ask questions, or propose alternatives, we are asked to wait a while for additional information and told that everything will work out.
>
> We cannot discharge our responsibilities under such an environment.

13 The two remaining independent directors resigned on February 21 and May 5, 2014, respectively. In his resignation letter, Mr. Dodds explained his rationale, stating:

> I lacked confidence that I was receiving information and engaged in decision-making in the same manner as those Board members who are directly affiliated with the company or its parent.

14 The trial judge found, at para. 15 of his reasons, that the four directors who voted against the independent committee were "Essar-affiliated directors", that it was clear that the Ruia family did not want an independent committee, and that the Essar-affiliated directors voted accordingly.

15 The trial judge also found that the recapitalization and the Port Transaction were run by Joe Seifert, Chief Investment Officer of Essar Capital. The trial judge rejected the contention that Mr. Seifert was merely an advisor to the Board that independently made all of the critical decisions. Rather, Essar Global and Essar Capital, led by Mr. Seifert, directed and made decisions relating to the recapitalization and the Port Transaction. As the trial judge noted at para. 49, the evidence was "overwhelming" that Essar Global and Essar Capital were "calling the shots".

(4) Restructuring Support Agreement

16 Essar Global engaged Barclays Capital, an investment bank, to pursue alternative financing structures for Algoma on behalf of Essar Global. Barclays introduced GIP to Mr. Seifert of Essar Capital. In May 2014, representatives of Essar Global, GIP, and Barclays met to discuss Algoma's infrastructure assets and potential asset disposition transactions. They discussed the possibility of a transaction in which Algoma might sell its Port assets to a new corporate entity to generate cash proceeds, but not for the purpose of recapitalizing Algoma. Rather, the proceeds would flow upstream to Essar Global. In light of Algoma's prior insolvencies, GIP thought it important that a separate corporate entity distinct from Algoma be established to hold the Port assets. By the end of June 2014, Algoma had an exclusivity agreement with GIP regarding GIP's loan to finance the Port Transaction.

17 Soon after entering into the exclusivity agreement with GIP, on July 24, 2014, Algoma entered into a Restructuring Support Agreement (the "RSA") with Essar Global and an *ad hoc* committee of Algoma's unsecured noteholders. The RSA set out the principal terms of a restructuring. It provided for a reduction of Algoma's debt through the exchange of the unsecured notes in return for the payment of a percentage of their original principal amount and the issuance of new notes. The note restructuring would be implemented through a court-approved *CBCA* Plan of

Arrangement. As a condition of the RSA and pursuant to an Equity Commitment Letter dated July 23, 2014, Essar Global agreed to acquire equity in Algoma for cash in the minimum amount of US$250 million and subject to a maximum of US$300 million. The trial judge found that Essar Global never intended to honour this obligation.

18 The Equity Commitment Letter provided a remedy in the event of a breach. The Plan of Arrangement contained a release of any claim arising out of the Equity Commitment Letter in favour of Essar Global, the noteholders, and the other corporations participating in the Arrangement.

19 It was a condition of the proposed Plan of Arrangement that Essar Global would comply with its RSA obligation to provide the aforementioned cash equity infusion. However, as early as March 28, 2014, representatives of the Ruia family had made it clear that they did not have US$250 million for equity. Efforts were made to reduce Essar Global's contribution. In late July 2014, one of the Ruia representatives wrote that ideally the equity contribution would be kept to US$150 to US$160 million.

20 Nonetheless, an application for approval of the Plan of Arrangement was made to the court. The recapitalization contemplated by the RSA was approved as an arrangement under s. 192 of the *CBCA* on September 15, 2014.

21 Beginning in October 2014, roadshow presentations were made to market the securities being offered through the recapitalization. However the transaction marketed did not accord with the transaction contemplated by the RSA. First, the roadshow presentation described an Essar Global cash equity contribution in Algoma of less than US$100 million, not the US$250 to US$300 million described in the RSA. Second, the presentation provided for the cash to be generated from the sale of the Port by Algoma. The RSA did not allow for such a sale absent the noteholders' consent. No such consent had been obtained. In addition, the proceeds of any sale were to be used to reduce Algoma's debt.

22 The roadshow was unsuccessful and investors failed to subscribe for the securities marketed. The lead bookrunner attributed this failure to the perception among investors that the transaction described in the roadshow presentation contemplated an insufficient contribution of equity into Algoma by Essar Global.

23 And so it was that Algoma was left without the cash to repay or refinance its debt.

24 Ultimately, the RSA was amended on November 6, 2014, such that Essar Global contributed US$150 million rather than the cash contribution of between US$250 and US$300 million originally contemplated by the Equity Commitment Letter. The amended RSA went on to provide that upon fulfillment of this revised contribution, Essar Global was deemed to have satisfied all of its obligations under the Equity Commitment Letter. The releases contained in the original filing were repeated in the amended Plan of Arrangement.

25 As subsequently discussed, in light of the amended RSA, an amended Plan of Arrangement was approved on November 10, 2014.

(5) Port Transaction

26 The Port Transaction closed on November 14, 2014. In summary, Algoma sold to Portco the Port assets consisting of the Port buildings, the plant, and machinery, but not the land. Algoma leased the realty to Portco for a term of 50 years. Portco agreed to provide Port cargo handling services in return for a monthly payment from Algoma to Portco. Algoma agreed to provide to Portco the services necessary to operate the Port in return for a monthly payment from Portco that would be less than the monthly payment paid by Algoma to Portco for cargo handling services.

27 Turning to the details of the Port Transaction, Algoma and Portco entered into a Master Sale and Purchase Agreement ("MSPA"). Under the MSPA:

(i) Algoma conveyed to Portco all of the fixed assets owned and used by Algoma in relation to the Port, and agreed to lease the realty to Portco;

(ii) Portco agreed to pay Algoma US$171.5 million to be satisfied by:

- a cash payment by Portco of US$151.66 million; and

- the issuance of an unsecured promissory note in the amount of US$19.84 million payable in full on November 13, 2015.

28 To fund these obligations, Portco obtained a US$150 million term loan from GIP. GIP Primus, L.P. lent US$125 million, while Brightwood Loan Services LLC lent US$25 million. This term loan was secured by all of Portco's current and future real and personal property and supported by two guarantees in favour of GIP: one from Essar Global, and another from Algoma Port Holding Company Inc., Portco's direct parent.

29 Pursuant to the MSPA, Algoma and Portco executed five additional documents: a promissory note, a lease, a Shared Services Agreement, an Assignment of Material Contracts Agreement, and a Cargo Handling Agreement.

(i) Promissory Note

30 The promissory note was for US$19.84 million payable by Portco to Algoma. Portco immediately assigned its obligations under the promissory note to Essar Global. Essar Global therefore became the obligor under the note and Algoma released Portco from its obligation. As of the date of the trial, the promissory note remained unpaid. At para. 27 of a subsequent decision

released on June 26, 2017, the trial judge granted a declaration that any amounts owing to Algoma under the promissory note given by Portco to Algoma have been set-off against amounts owing by Algoma to Portco under the Cargo Handling Agreement: 2017 ONSC 3930, 53 C.B.R. (6th) 321. The decision allows for set-off against Portco, but preserves GIP's right to repayment.

(ii) Lease

31 Under the lease, Portco leased from Algoma the Port lands, roads, and outdoor storage space for a 50-year term. Portco prepaid Algoma the rent for the entire 50-year period. The present value of this leasehold interest was stated to be US$154.8 million. Algoma maintained responsibility for all maintenance, repairs, insurance, and property taxes.

(iii) Shared Services Agreement

32 Under the Shared Services Agreement, Algoma was to be responsible for providing all the services necessary for Portco to fulfill its obligations under the Cargo Handling Agreement. These services were to be provided by Algoma employees, not Portco employees. Portco agreed to pay Algoma US$11 million annually subject to escalation at the rate of 3 percent per annum beginning in 2016.

(iv) Assignment of Material Contracts

33 Under the Assignment of Material Contracts Agreement, Algoma provided a covenant in favour of GIP, which precluded Algoma from selling or assigning any material contract relating to the Port, including the Cargo Handling Agreement except by way of security granted to its other third party lender.

(v) Cargo Handling Agreement

34 Under the Cargo Handling Agreement, Portco agreed to provide Algoma with cargo handling services for an initial 20-year term with automatic renewal for successive three-year periods unless either party gave written notice of termination to the other. Algoma agreed to pay Portco based on tonnage with a minimum monthly assured volume of US$3 million. In other words, Algoma was obliged to pay a minimum of US$36 million annually to Portco for 20 years subject to an escalation in price of 1 percent per annum commencing in 2016. Therefore, while Algoma was entitled to US$11 million annually under the Shared Services Agreement, it had to pay Portco at least US$36 million annually under the Cargo Handling Agreement, such that Portco would receive an annual revenue stream from Algoma of US$25 million. This amount was intended to service GIP's term loan at US$25 million a year. However, GIP's loan had a term of eight years, and therefore Portco would have the full benefit of the US$25 million for at least 12 years of the initial 20-year term of the Cargo Handling Agreement, and potentially for 42 years if the Agreement was not terminated.

35 Section 15.2 of the Cargo Handling Agreement also contained a change of control clause that

stated that the "Agreement may not be assigned by either Party without the prior written consent of the other Party." This provision became particularly contentious because it effectively gave Portco -- and therefore Portco's parent, Essar Global -- a veto over any party acquiring Algoma in the *CCAA* proceedings.

36 Although inclusion of the change of control provision in the Cargo Handling Agreement was driven by GIP, the trial judge found that it was effectively for the benefit of Essar Global, as it gave Portco a veto. Furthermore, the trial judge noted at para. 117 that Essar Global had in fact relied on s. 15.2 to its benefit, by holding out its change of control rights to dissuade competing bidders for Algoma in the restructuring process while Essar Global continued to express its own interest as a prospective bidder.

37 In discussing the financial ramifications of the Shared Services Agreement and the Cargo Handling Agreement, the trial judge observed at para. 26 of his reasons:

> When the costs of operating the Port (shared services) are netted from the cargo handling charges, the result is that Algoma will pay approximately $25 million per year to Portco, which is the amount required by Portco to service the Term Loan each year. That amount of $25 million for 20 years comes to $500 million, far more than the amount needed to repay the $150 million GIP loan.

38 Duff & Phelps assessed the fair value of the Portco Transaction as ranging between US$150.9 million and US$174.2 million with a midpoint of US$161.7 million. However, this assessment failed to take into account the change of control provision in the Cargo Handling Agreement. Deloitte LLP reviewed Duff & Phelps' assessment and concluded it was reasonable.[2]

(6) Final Recapitalization

39 Ultimately the recapitalization of Algoma consisted of the following transactions:

(a) Algoma issued US$375 million in senior secured notes pursuant to an offering memorandum;

(b) Algoma entered into a new US$50 million senior secured asset-based revolving credit facility and a new US$375 million term loan;

(c) Algoma's unsecured noteholders were paid a portion of their principal and were issued new junior secured notes;

(d) Algoma completed the Port Transaction;

(e) Essar Global contributed US$150 million in cash in exchange for common equity, and also contributed US$150 million in debt forgiveness; and

(f) All other Algoma lenders were repaid in full.

40 In addition, GIP entered into a secured term loan for US$150 million with Portco, secured by a GSA over all of Portco's assets. It also received guarantees -- one from Essar Global and one from Algoma Port Holding Company Inc. -- guaranteeing Portco's liabilities. In November 2014, the transactions in furtherance of Algoma's recapitalization, including the Port Transaction, were approved unanimously by Algoma's Board of Directors after receiving advice and on the recommendation of Algoma's management. By this time, the Board consisted of four directors: Mr. Kishore Mirchandani, who became a director on June 23, 2014; Mr. Naresh Kothari, who became a director on August 24, 2014; the Board's chair, Mr. Jatinder Mehra of Essar Global; and Algoma's CEO, Mr. Kalyan Ghosh. Mr. Ghosh, and Mr. Rajat Marwah, Algoma's CFO, both testified that they supported the Port Transaction not because it was ideal, but because there was no other option given Essar Global's failure to capitalize Algoma as it had committed to do.

41 As mentioned, the approved Plan of Arrangement that included the original RSA had to be amended in light of the revised equity contribution. A *CBCA* Plan of Arrangement incorporating the recapitalization and authorizing the amendment of the September 2014 approval order was granted by Morawetz J. on November 10, 2014.

42 Based on the materials before this court, it would appear that the Port Transaction was not mentioned or brought to Morawetz J.'s attention. In this regard, the trial judge found that there was no reference to the Port Transaction in the affidavits filed in support of the amendment to the Plan of Arrangement. The Port Transaction is not mentioned in that order or in any endorsement.

43 The outcome of the Port Transaction was that all Port assets were transferred from Algoma to Portco, the Port lands were leased to Portco for 50 years, and Portco obtained change of control rights. Portco paid Algoma US$151,660,501.50 in cash, provided the US$19,840,000 promissory note, and was obliged to pay Algoma US$11 million per annum under the Shared Services Agreement. In turn, Algoma was obliged to pay Portco US$36 million per annum for an initial term of 20 years under the Cargo Handling Agreement, subject to renewal, netting Portco US$25 million per annum as against the Shared Services Agreement payments. Meanwhile, under the revised RSA, Essar Global contributed cash of US$150 million to Algoma rather than the original cash commitment of US$250 to US$300 million.

(7) Insolvency Protection Proceedings

44 On November 9, 2015, Newbould J. granted an order placing Algoma, Essar Tech Algoma

Inc., Algoma Holdings B.V., Essar Steel Algoma (Alberta) ULC, Cannelton Iron Ore Company, and Essar Steel Algoma Inc. USA (the "*CCAA* Applicants") under *CCAA* protection. As mentioned, he appointed Ernst & Young Inc. as the Monitor. The order contained various paragraphs addressing the rights and obligations of the Monitor, including a direction to perform such duties as were required by the Court. On November 20, 2015, Morawetz J. granted an Amended and Restated Initial Order that, among other things, directed the Monitor to review and report to the Court on any related party transactions (expressly including the Port Transaction).

45 During the *CCAA* proceedings, on February 10, 2016, a sales and investment solicitation process ("SISP") for Algoma's business and property was approved by the Court. Essar North America, a subsidiary of Essar Global, submitted a bid but was disqualified in April 2016 under the terms of the SISP because it failed to provide sufficient evidence of financial ability to purchase. In May and July of 2016, Essar Global persisted in its efforts to be the purchaser of the *CCAA* Applicants. On May 10, 2016, counsel to Portco, who was also counsel to Essar Global, wrote to counsel for Algoma to highlight matters of particular concern in connection with the *CCAA* process. The letter stated that any prospective bidder was to be told of the consent or veto right:

> Portco and [Algoma] are party to a Cargo Handling Agreement pursuant to which [Algoma] has committed to long-term use of the port. Portco, has, of course, a keen interest in any successor to [Algoma] as counterparty to that agreement and would like it to be clear to prospective bidders that, pursuant to the terms of the Cargo Handling Agreement, Portco has a consent right in the event of any assignment by [Algoma] of the agreement or a change of control of [Algoma].
>
> Again please confirm that this has been made clear to prospective bidders.

46 On June 20, 2016, the Monitor filed its Thirteenth Report, which described the Portco Transaction and indicated that there may be grounds for further review of that transaction. The Monitor noted that the renegotiated equity commitment resulted in Essar Global contributing the sum of US$150 million in equity rather than US$250 to US$300 million, and that the Portco Transaction transferred control of one of Algoma's most critical assets, the Port, to Essar Global. The Monitor stated that it remained "particularly concerned about the effect on the completion of a restructuring transaction of the restrictions on assignment in the Portco Transaction documents."

47 On September 26, 2016, Deutsche Bank AG, who led the Debtor-in-Possession ("DIP") Lenders of Algoma and also represented the interests of potential bidders in the *CCAA* process, applied for an order empowering the Monitor to commence certain proceedings and make certain investigations.[3] On September 26, 2016, Newbould J. granted an order authorizing the Monitor to commence and continue proceedings under s. 241 of the *CBCA* in relation to related party transactions, including but not limited to the Port Transaction.

48 The action proceeded on an accelerated timetable due to the progress of the *CCAA* restructuring.[4] On October 20, 2016, the Monitor commenced proceedings claiming oppression pursuant to s. 241 of the *CBCA* against Essar Global and others in the Essar Group including Portco. It pleaded that by reason of its role as a court officer directed to commence the oppression proceedings and to oversee the interests of all stakeholders of Algoma, it was a complainant within the meaning of ss. 238 and 241 of the *CBCA*.

49 It alleged that since June 2007, the Essar Group had exercised *de facto* control over Algoma and had engaged in a course of conduct that consistently preferred the interests of the Essar Group and in particular, Essar Global, to those of Algoma and its stakeholders. This included the transfer to the Essar Group of long-term control over, and a valuable equity interest in, Algoma's Port facilities, an irreplaceable and core strategic asset of Algoma. The value of control over the Port to Algoma and its stakeholders was immeasurable, since Algoma's business could not function without access to the Port.

50 The Monitor pointed out that the Essar Group obtained its control and equity interest in the Port through a cash contribution of less than US$4.7 million. It pleaded that the US$150 million raised as part of the Port Transaction came from third party lenders, namely GIP, and was money raised against the security and value of the Port facilities, an asset of Algoma, as well as a promissory note that remained unpaid, and a guarantee from Essar Global. The Monitor also stressed that the control obtained by the Essar Group was not only over the Port facilities, but extended to any sale of the Algoma business such that Essar Global had an indirect veto on transactions involving Algoma's enterprise. Essar Global also obtained a right to substantial payments under the Cargo Handling Agreement.

51 The oppression occasioned was exacerbated by the fact that the borrowed monies raised through the transaction were a substitution for monies Essar Global had promised to contribute as equity in Algoma.

52 The Monitor also argued that s. 15.2 of the Cargo Handling Agreement itself constituted oppression, because it was for the long-term benefit of Essar Global and not in the interests of Algoma's non-shareholder stakeholders. The Monitor took the position that the provision gave Portco and Essar Global a veto over any party acquiring Algoma in the *CCAA* process, thus negatively affecting the sales process. The Monitor also argued that the change of control provision was not necessary for the protection of GIP because it had its own change of control rights under its credit agreement.

53 In addition, the Monitor pleaded that the oppression and prejudice to creditors was continuing as Essar Global and other related companies had insisted that bidders for Algoma's business under the SISP, which was approved by the court on February 11, 2016, be advised of Portco's consent rights under the change of control clause in the Cargo Handling Agreement.

54 Essar Global and the remaining defendants filed their defence rejecting the Monitor's

allegations, describing the action as "an improper and ill-conceived leverage tactic". They asserted that the litigation was an attempt to attack the Port Transaction for the benefit of other bidders under the sales process, including the DIP Lenders. They pleaded that the Monitor had no standing, the claim was improperly pleaded, an oppression remedy seeking to unwind or claim damages in respect of the Port Transaction was unavailable at law, and in any event there was no oppression, prejudice, or unfairness.

55 Portco's lenders, GIP, were granted intervener status as parties on December 22, 2016. They noted that they were *bona fide*, arm's length, and independent commercial parties and no cause of action or wrongful conduct was asserted by the Monitor against them. Nonetheless, the Monitor was seeking remedies that eviscerated the security held by them. They asserted that the Monitor did not have standing and could not establish any oppressive conduct in any event. Moreover, the structure of the Port Transaction was transparent to all of Algoma's stakeholders. Lastly, even if the court granted a remedy to the Monitor, it had no jurisdiction to prejudice the interests of GIP. The Monitor subsequently amended its statement of claim to modify the language on the relief claimed relating to the indebtedness and security interests in favour of GIP.

56 Various procedural motions were brought. Others who are not before this court intervened: Deutsche Bank AG; the Ad Hoc Committee of Algoma's Noteholders; Algoma Retirees; and two locals from the union United Steelworkers, Locals 2724 and 2251. The Essar Group and GIP brought motions to strike on the basis that the Monitor lacked standing and later also sought an order for particulars. On December 1, 2016, Newbould J. ordered that the standing motions be dealt with at the trial scheduled for January 30, 2017. On January 5, 2017, he urged the Monitor to give as many particulars as it could regarding the relief it might seek.

57 On January 30, 2017, Essar Capital served a motion for an order re-opening the SISP and to make information available to Essar Global to allow it to consider submitting a bid. Newbould J. dismissed the request. At para. 114 of his reasons, the trial judge found that Essar Global was still interested in purchasing the assets of Algoma.

58 The action proceeded to a five-day trial before Newbould J. commencing on January 31, 2017.

B. TRIAL JUDGMENT

59 The trial judge organized his reasons for decision under six principal headings: the Monitor's standing; who directed the recapitalization and the Port Transaction; reasonable expectations and were they violated; the business judgment rule; and the appropriate remedy. I will summarize his conclusions on each issue.

(1) Monitor's Standing

60 As mentioned, both Essar Global and GIP challenged the Monitor's standing as a complainant under the oppression provisions of the *CBCA*. They also argued that only persons directly damaged

by the oppressive conduct could bring the action and that this action was in substance a derivative claim by Algoma. The trial judge rejected these arguments.

61 He found that the stakeholders harmed were Algoma's trade creditors, pensioners, retirees, and employees. At para. 32, he noted that Algoma owed CDN$911.9 million as of the date of the Port Transaction to a group of creditors including trade creditors, pensioners, retirees, and the City of St. Sault Marie.

62 The trial judge acknowledged at para. 34 that normally a monitor, who is a court officer, is to be neutral and not take sides. However, there are exceptions. Under s. 23(1)(k) of the *CCAA*, a monitor must carry out any function in relation to the debtor that the court may direct. At para. 35, the trial judge also pointed to the *CCAA* proceedings of Nortel Networks Corp. as a precedent: *Nortel Networks Corp., Re* (3 October 2012), Toronto, 09-CL-7950 (Ont. S.C.J. [Commercial List]). In those proceedings, a monitor was authorized to act as a litigant after all of Nortel's directors and senior executives had resigned.

63 Moreover, the trial judge observed that determining whether someone is a complainant under s. 238 of the *CBCA* is a discretionary decision. In *Olympia & York Developments Ltd. (Trustee of) v. Olympia & York Realty Corp.* (2003), 68 O.R. (3d) 544 (C.A.), this court confirmed that a trustee in bankruptcy acting on behalf of the creditors of a bankrupt estate could be a complainant within the meaning of s. 238. In so doing, the court noted the need for flexibility to ensure that the remedial purpose of the oppression provisions is achieved. The trial judge saw no reason why the principle of collective action -- which posits that it is more efficient for creditors to pursue their claims in a bankruptcy collectively with a trustee acting as their representative rather than individually -- should not be followed in the present *CCAA* proceeding. At para. 37, he concluded that the Monitor had taken the action as an adjunct to its role in facilitating a restructuring and was therefore a proper complainant.

64 To respond to Essar Global and GIP's arguments that the claim was properly a derivative action and that no person had been personally harmed beyond Algoma, at para. 40 the trial judge relied on *Rea v. Wildeboer*, 2015 ONCA 373, 126 O.R. (3d) 178, at para. 27. There, Blair J.A. commented that the derivative action and the oppression remedy are not mutually exclusive. Although on the facts of *Wildeboer*, Blair J.A. had struck out a statement of claim pleading the oppression remedy, the trial judge distinguished *Wildeboer* on the basis that the relief sought was for the benefit of the corporation and there was no allegation that individualized personal interests were affected by the alleged wrongful conduct.

(2) Essar Global Directed the Recapitalization and the Portco Transaction

65 The trial judge observed that in some respects, it did not matter who made the decisions regarding the recapitalization and the Port Transaction -- if the conduct was oppressive, relief could be granted. Nonetheless, he found at para. 49, that the evidence was "overwhelming" that Essar Global and Essar Capital were "calling the shots."

66 At para. 52, he accepted the evidence of Mr. Ghosh and Mr. Marwah that they did not negotiate the economic terms of the refinancing or the Port Transaction. Nor was either involved in the renegotiation of the RSA.

67 The trial judge relied on other evidence, including Algoma's annual Business Plan dated February 3, 2014, to support his factual findings. He also considered evidence of the witnesses. He found at paras. 56-57 that some of the witnesses had been evasive, including: Rewant Ruia, the Ruia family's lead in the Essar Group's North American operations; Mr. Seifert,; and Rajiv Saxena, the Executive Director of Essar Steel India Ltd.

68 After reviewing the evidence, the trial judge noted at para. 58 that he was satisfied that Mr. Seifert, who represented the Essar Group's interests, had primary responsibility for pursuing the recapitalization negotiations and Algoma's refinancing via the Port Transaction. He concluded at para. 60:

> I am satisfied that representatives of Essar Global including Essar Capital carried out the Recapitalization and Portco Transaction negotiations and made the critical decisions. Algoma management were handed the economic terms of the Recapitalization and Port Transaction and implemented them from an operational perspective. Algoma management did not negotiate the terms. Their role was to support the negotiations with regard to non-economic, primarily operational, issues.

(3) Reasonable Expectations and their Violation

69 The trial judge identified the two-step process to determine whether a violation of reasonable expectations has occurred under s. 241 of the *CBCA*, which is described at para. 68 of *BCE Inc. v. 1976 Debentureholders*, 2008 SCC 69, [2008] 3 S.C.R. 560: (i) does the evidence support the reasonable expectation asserted by the complainant; and (ii) does the evidence establish that the reasonable expectation was violated by conduct that is oppressive, unfairly prejudicial, or unfairly disregards a relevant interest?

70 He described the reasonable expectations asserted by the Monitor as relating to the loss by Algoma of a critical asset and the change of control clause in the Cargo Handling Agreement. He stated at para. 64:

> The Monitor contends that the reasonable expectations of the creditors of Algoma, including the trade creditors, employees, pensioners and retirees, were that Algoma would not deal with its core assets like the Port in such a way as it would lose long-term control and value over those assets to a related party on terms that permitted the related party to veto or thwart Algoma's ability to do significant transactions or restructure, as was done in this case.

71 At para. 67, the trial judge did not accept that the expectations of creditors such as the employees, pensioners, and retirees were governed only by their agreements with Algoma. Furthermore, the evidence, including the inferences drawn from the circumstances that existed at Algoma in 2014, supported the expectations relied upon by the Monitor. He noted at para. 73 that stakeholders have a reasonable expectation of fair treatment and this was particularly so in Sault Ste. Marie, where Algoma is of critical importance to the local economy and relied upon greatly by trade creditors and employees.

72 He concluded at para. 75 that:

> [T]he reasonable expectations of the trade creditors, the employees, pensioners and retirees of Algoma were that Algoma would not deal with a critical asset like the Port in such a way as to lose long-term control over such a strategic asset to a related party on terms that permitted the related party to veto and control Algoma's ability to do significant transactions or restructure and which gave unwarranted value to the third party.

73 The trial judge held that the reasonable expectations of the trade creditors, employees, pensioners, and retirees were violated in two principal ways: first, the Port Transaction itself; and second, the change of control veto provided to Portco, and thus Essar Global, in the Port Transaction.

74 The Port Transaction was caused by Essar Global's breach of both the RSA and the Equity Commitment Letter. Because the lease of the land from Algoma to Portco was for 50 years and Essar Global was in a position to terminate the Cargo Handling Agreement after 20 years, Algoma would be at Essar Global's mercy for the duration of these agreements. The trial judge found at para. 78 that the transfer of the Port assets to Portco was driven by GIP's desire for a "bankruptcy remote" special purpose vehicle. GIP was aware of Algoma's previous insolvencies and would only lend to a new entity that held the Port assets and that was separate from Algoma.

75 The Port Transaction and the GIP secured loan to Portco would not have been necessary had Essar Global lived up to its obligations under the RSA and the Equity Commitment Letter under which Essar Global had pledged a cash investment of US$250 to US$300 million. The trial judge found at para. 82 that Essar Global had no intention of living up to its promises and had acted in bad faith in this regard. The content of the roadshow presentations reflected the discordance with the RSA. The alternative transaction in the roadshow presentations contemplated cash being contributed to the recapitalization through the sale of the Port. That these presentations failed was partially attributable, as the trial judge found at para. 82, to Essar Global's insufficient contribution of cash equity into Algoma.

76 The trial judge concluded that Essar Global's decision not to fund Algoma according to the terms of the Equity Commitment Letter made it necessary to carry out the Port Transaction. GIP's loan of US$150 million reduced the amount of cash equity Essar Global promised to advance to

Algoma. Essar Global's failure to inject cash equity into Algoma as agreed was the root cause of the Port Transaction and the transfer of control. This was, as the trial judge concluded at para. 89, an exercise in bad faith. Had an independent committee of Algoma's Board of Directors been struck, Essar may have been held to its bargain rather than looking to third party financing from GIP under the Port Transaction structure. The Board's failure to examine alternatives to effect Algoma's recapitalization indicated a lack of regard for the interests of Algoma's stakeholders.

77 Additionally, the long-term value given to Essar Global by the Port Transaction was itself oppressive (although in stating this, the trial judge noted that the Monitor did not pursue its claim that the Port assets were transferred to Portco at an undervalue).

78 As for the release in the amended RSA, the trial judge observed that it was a release of any claim arising out of the Equity Commitment Letter. The trial judge found at para. 100 that the Monitor was not making a claim under that Letter, nor was it asking that Essar Global provide the equity it had promised in that commitment. Rather, Essar Global's failure to live up to its commitment was part of the factual circumstances to be taken into account in considering whether Algoma's stakeholders were treated fairly under the Port Transaction.

79 The trial judge also observed that when the court approved the amended Plan of Arrangement under the amended RSA, it did not have knowledge of the Port Transaction. There was no reference to the Port Transaction in the affidavits filed in support of the amendment to the Plan of Arrangement; there was no finding relating to the release of Essar Global; the trade creditors, the employees, pensioners and retirees were not parties to the motion approving the amended RSA; and the order was obtained without opposition.

80 Ultimately he concluded that the Port Transaction was itself unfairly prejudicial to, and unfairly disregarded, the interests of Algoma's trade creditors, employees, pensioners, and retirees.

(4) Change of Control Provision

81 The trial judge determined at para. 104 that the change of control provision gave effective control to Portco (*i.e.* Essar Global) over who may acquire the Algoma business. Any buyer of Algoma or its business would need to be assigned the Cargo Handling Agreement so that it could operate the steel mill. Therefore the veto under this clause was effectively a veto over any change of control of the Algoma business.

82 Although the evidence indicated that the change of control provision was included for GIP's protection, the trial judge found that this end could have been achieved in other ways. For example, as the trial judge pointed out at para. 110, the parties could have included a provision in the Assignment of Material Contracts Agreement that prevented a change of control of Algoma without GIP's explicit consent. Such an alternative might have been considered had there been a committee of independent directors with advisors independent of Essar Global. But, as the trial judge concluded at para. 111, the reality was that there was no pushback on the change of control

provision that was implemented, and which gave Portco/Essar Global a veto.

83 The trial judge concluded at para. 113 that the change of control provision was of considerable value to Essar Global. Furthermore, as mentioned, the trial judge stated at para. 117 that Essar Global had in fact relied on s. 15.2 to its benefit by holding out its change of control rights to dissuade competing bidders for Algoma in the restructuring process while Essar Global continued to express its own interest as a prospective bidder.

84 The May 10, 2016 letter from Portco's counsel, which sought confirmation from Algoma's counsel that prospective bidders would be advised of Portco's rights, exemplified this. In the letter, Essar Global effectively held out its consent to any change of control right to dissuade competing bidders for Algoma in the restructuring process while it continued to express its own interest as a prospective bidder. The trial judge observed at para 115 that: "[I]t is clear that the dictate of Portco through its solicitors that prospective purchasers should be made aware of the change of control provision was successful".

85 The trial judge also observed that the evidence established that Portco's right to refuse assignment of the Cargo Handling Agreement was a material impediment to restructuring Algoma as Algoma could not survive without access to the Port. He concluded that the change of control provision in favour of Portco in the Cargo Handling Agreement was unfairly prejudicial to, and unfairly disregarded, the interests of Algoma's trade creditors, employees, pensioners, and retirees.

(5) The Business Judgment Rule

86 The trial judge also determined that the business judgment rule, which accords deference to a business decision of a Board of Directors so long as the decision lies within a range of reasonable alternatives, did not provide a defence to Essar Global. The Board had not followed advice that it insist Essar Global comply with its commitments under the RSA and the Equity Commitment Letter. As the trial judge stated at para. 123, the result of this was the Port Transaction, which was:

> [A]n exercise in self-dealing in that Algoma's critical Port asset was transferred out of Algoma to a wholly owned subsidiary of Essar Global with a change of control provision that benefitted Essar Global at a time that a future insolvency was a possibility.

87 Moreover, there was no evidence that the Board even considered whether protection to GIP could be provided in the absence of the change of control provision in favour of Portco and hence Essar Global. This failure was unreasonable.

(6) Remedy

88 The trial judge stated at para. 136 that if there were no less obtrusive way to remedy the oppression, he would have ordered that Portco's shares be transferred to Algoma. However, mindful

that a remedy for oppression should be approached with a scalpel, he instead relied on s. 241(3) of the *CBCA* to order a variation of the Port Transaction. He accordingly deleted s. 15.2 of the Cargo Handling Agreement and inserted a provision in the Assignment of Material Contracts Agreement, which provided that, if GIP becomes the equity owner of Portco, its consent would be required for a change of control of Algoma. He rejected the suggestion that either GIP or Essar Global were taken by surprise by this relief.

89 He also addressed the imbalance created by the 50-year term of the lease between Algoma and Portco as against the 20-year term of the Cargo Handling Agreement (with automatic renewal for successive three year periods, barring either party's termination). As the Port was critical to Algoma's operation and survival, Algoma's ability under the Cargo Handling Agreement to refuse an extension after 20 years was illusory and, in reality, the renewal provision was one-sided in favour of Essar Global.

90 He concluded at para. 144 that the payments under the Cargo Handling Agreement were an unreasonable benefit in favour of Essar Global. If the Agreement lasted only the initial 20-year term, Portco/Essar Global would receive US$300 million after GIP's loan was paid off. If the Agreement was not terminated before the end of its 50 year life, Portco/Essar Global would receive an additional US$750 million for the last 30 years.

91 Accordingly, the trial judge ordered that the lease, the Cargo Handling Agreement, and the Shared Services Agreement be amended to provide Algoma with the option to terminate any of these three agreements once GIP's loan matured and was paid. If Portco elected not to renew after 20 years, or any of the three-year extensions, those three agreements would terminate, and Algoma would then owe Portco US$4.2 million plus interest.

92 The trial judge decided at para. 147 that the appropriate place for Portco to assert its claims for a declaration that the US$19.8 million promissory note had been paid as a result of set-off and for amounts owing under the Cargo Handling Agreement was in the ongoing *CCAA* proceedings.

(7) Costs

93 Lastly, following the release of the judgment, Essar Global agreed to pay costs of CDN$1.17 million to the Monitor. The trial judge then ordered Essar Global to pay Algoma CDN$1.5 million in costs and ordered that no costs be payable by the Monitor or by or to GIP.

C. ISSUES

94 There are eight issues to be addressed:

1. Did the Monitor lack standing to be a complainant under s. 238 of the *CBCA*?

2. Could the claim of the Monitor only be brought as a derivative action under s. 239 of the *CBCA* rather than an oppression action under s. 241 of the *CBCA*?

3. Did the trial judge err in his analysis of reasonable expectations?

4. Did the trial judge err in his analysis of wrongful conduct and harm?

5. Did the trial judge err in tailoring a remedy?

6. Was there procedural unfairness?

7. Should the fresh evidence be admitted?

8. Should leave to appeal costs be granted to GIP and the costs award varied?

D. ANALYSIS

(1) Standing of the Monitor

95 Essar Global submits that the Monitor is not a proper complainant given the conflict between it and the stakeholders it represents. The trial judge failed to consider whether the Monitor could avoid conflicts.

96 GIP supports the position of Essar Global. It states that the trial judge erred in assuming that the court's broad jurisdiction under the *CCAA* could be combined with the equally broad jurisdiction under the *CBCA* to create a super remedy that would interfere with the contractual rights of non-offending third parties. A trustee in bankruptcy is a representative of the creditors of the bankrupt. A monitor owes duties to all stakeholders, not just creditors. Its duty to Essar Global as sole shareholder of Algoma cannot be reconciled with the Monitor's oppression claim against it. Also, Algoma can be directed to make the Cargo Handling Agreement payments to GIP directly and therefore the Monitor owed a fiduciary duty to GIP.

97 In addressing this issue, I will first discuss the evolution of the role of a monitor. I will then discuss who can be a complainant under the *CBCA* oppression provisions. Lastly, I will consider whether in the particular circumstances of this case, the trial judge was correct in concluding that the Monitor could have standing to bring an oppression action.

(a) The Purpose of *CCAA* Restructurings

98 As has been repeatedly described, the *CCAA* was originally enacted in 1933 to respond to the ravages of the Great Depression and to allow large corporations with outstanding bonds and debentures to restructure their debt in a court-supervised process through plans of arrangement or compromise negotiated with their creditors.

99 As outlined by Deschamps J. in *Ted Leroy Trucking [Century Services] Ltd.*, Re, 2010 SCC 60, [2010] 3 S.C.R. 379, the *CCAA* fell into disuse after amendments in 1953 that limited its application to companies issuing bonds. Courts breathed new life into the statute in the early 1980s in response to an economic recession, and the *CCAA* became the primary vehicle through which major restructurings were attempted. Amendments to the *Bankruptcy and Insolvency Act*, R.S.C. 1985, c. B-3 (the "*BIA*"), introduced in 1992, allowed insolvent debtors to make proposals to creditors under that statute, and were expected to supplant the *CCAA*. However, the *CCAA* continues to be employed as the vehicle of choice to restructure large corporations, particularly where flexibility is needed in the restructuring process: Roderick J. Wood, *Bankruptcy & Insolvency Law*, 2nd ed. (Toronto: Irwin Law, 2015), at pp. 336-337; and *Century Services*, at para. 13.

100 The corporate restructuring process at the heart of the *CCAA* "provide[s] a constructive solution for all stakeholders when a company has become insolvent": *Indalex Ltd., Re*, 2013 SCC 6, [2013] 1 S.C.R. 271, at para. 205. There are a number of justifications for why such a process is desirable. The traditional justification for *CCAA*-enabled restructurings, as explained by Duff C.J. shortly after the statute's enactment, was to rescue financially-distressed corporations without forcing them to first declare bankruptcy: *Reference Re Constitutional Validity of the Companies' Creditors Arrangement Act (Dom.)*, [1934] S.C.R. 659, at p. 661.

101 The restructuring process can also allow creditors to obtain a higher recovery than may otherwise be available to them through bankruptcy or other liquidation proceedings, by preserving the corporate entity or the value of its business as a going concern: Wood, at pp. 338-339. Additionally, restructuring proceedings can provide an opportunity to evaluate the root of a corporation's financial difficulties, and develop strategies to achieve a turnaround, whether the best option be a full restructuring, or a liquidation of the corporation within the restructuring regime: Wood, at p. 340.

102 The benefits of the restructuring process are not limited to creditors. Even early commentary lauded restructurings as promoting the public interest by salvaging corporations that supply goods or services important to the economy, and that employ large numbers of people: see Stanley E. Edwards, "Reorganizations Under the Companies' Creditors Arrangement Act" (1947), 25 Can. Bar Rev. 587, at p. 593. This view remains applicable today, with restructurings "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": *Century Services*, at para. 18.

103 To summarize, by enabling the restructuring process, the *CCAA* can achieve multiple objectives. It permits corporations to rehabilitate and maintain viability despite liquidity issues. It allows for the development of business strategies to preserve going-concern value. It seeks to maximize creditor recovery. It can serve to preserve employment and trade relationships, protecting non-creditor shareholders and the communities within which the corporation operates: see Janis P. Sarra, *Rescue! The Companies' Creditors Arrangement Act*, 2nd ed. (Toronto: Thomson Reuters, 2013), at pp. 13-17. The flexibility inherent in the restructuring process permits a broad balancing of these objectives and the multiple stakeholder interests engaged when a corporation faces insolvency.

104 It is against this background that the role of a monitor must be considered.

(b) The Role of the Monitor

105 Originally, the *CCAA* was a very slim statute and made no mention of a monitor. Born of the court's inherent jurisdiction, the term "monitor" was first used in *Re Northland Properties Ltd.* (1988), 29 B.C.L.R. (2d) 257 (S.C.). In that case, an interim receiver was appointed whose role was described at p. 277 as that of a monitor or watchdog. As a watchdog, the monitor could "observe the conduct of management and the operation of the business while a plan was being formulated": A.J.F. Kent and W. Rostom, "The Auditor as Monitor in CCAA Proceedings: What is the Debate?" (2008), online: Mondaq <www.mondaq.com>. The monitor was thus a court-appointed officer.

106 The 1997 amendments to the *CCAA* gave legislative recognition to the role of the monitor and made the appointment mandatory. The 2007 amendments to the *CCAA* expanded the description of the monitor's role and responsibilities. In essence, its minimum powers are set out in the Act and they may be augmented through the exercise of discretion by the court, typically the *CCAA* supervising judge. This framework is reflected in s. 23 of the *CCAA*, which enumerates certain duties and functions of a monitor. Paragraph 23(1)(k) directs that a monitor shall carry out "any other functions in relation to the company that the court may direct." Its express duties under s. 23(1)(c) include making, or causing to be made, any appraisal or investigation that the monitor "considers necessary to determine with reasonable accuracy the state of the company's business and financial affairs and the cause of its financial difficulties or insolvency". It is then to file a report on its findings.

107 Not surprisingly, as with the *CCAA* itself, the role of the monitor has evolved over time. As stated by David Mann and Neil Narfason in their article entitled "The Changing Role of the Monitor" (2008) 24 Bank. & Fin. L. Rev. 131, at p. 132:

> Born out of invention, the role has developed from one of passive observer to one of active participant. The monitor has enhanced communication, mediated disputes, provided input into plans of reorganization, and provided expert advice in complex affairs. As the business community has become more sophisticated and global, so too has the monitor--taking on larger mandates, often times

involving complex, cross-border restructurings.

108 Examples of the use of expanded powers for a monitor are found in *Philip's Manufacturing Ltd., Re* (1991), 67 B.C.L.R. (2d) 385 (C.A.), where the British Columbia Court of Appeal ordered a monitor to report on the causes of financial problems of the company and report on improper payments made to management, shareholders and directors, and in *Woodward's Ltd., Re* (1993), 77 B.C.L.R. (2d) 332 (S.C.), where Tysoe J. (as he then was) held that a monitor was to review all transactions and conveyances for fraud, preferences, or other reviewable features and act in a similar manner to a trustee in bankruptcy.

109 Under s. 11.7(1) of the *CCAA*, a monitor must be a licensed trustee in bankruptcy, and as such, under s. 13 of the *BIA*, is subject to the supervision of the Office of the Superintendent of Bankruptcy. The monitor is to be the eyes and the ears of the court and sometimes, as is the case here, the nose. The monitor is to be independent and impartial, must treat all parties reasonably and fairly, and is to conduct itself in a manner consistent with the objectives of the *CCAA* and its restructuring purpose. In the course of a *CCAA* proceeding, a monitor frequently takes positions; indeed it is required by statute to do so. See for example s. 23 of the *CCAA* that describes certain duties of a monitor.

110 Of necessity, the positions taken will favour certain stakeholders over others depending on the context. Again, as stated by Messrs. Kent and Rostom:

> Quite fairly, monitors state that creditors and the Court currently expect them to express opinions and make recommendations. ... [T]he expanded role of the monitor forces the monitor more and more into the fray. Monitors have become less the detached observer and expert witness contemplated by the Court decisions, and more of an active participant or party in the proceedings.

(c) A Monitor as Complainant in an Oppression Action

111 Turning to the issue of a monitor and an oppression action, there is some difference in academic opinion on the suitability of the oppression remedy in insolvency proceedings. Professor Stephanie Ben-Ishai has argued that the remedy should be unavailable for use once the debtor has entered a court-supervised reorganization under the *BIA* or the *CCAA*.[5] Professor Janis Sarra has countered that the oppression remedy continues to be an important corporate law remedy that should be available in such proceedings.[6] I do not understand the appellants to be taking the former position; rather they simply argue that the Monitor has no standing.

112 Section 238 of the *CBCA* defines a complainant as:

> (a) a registered holder or beneficial owner, and a former registered holder or beneficial owner, of a security of a corporation or any of its affiliates,

(b) a director or an officer or a former director or officer of a corporation or any of its affiliates,

(c) the Director, or

(d) any other person who, in the discretion of a court, is a proper person to make an application under this Part.

For the purposes of this analysis, s. 238(d) is the relevant subsection.

113 Section 241of the *CBCA* describes the oppression remedy:

(1) A complainant may apply to a court for an order under this section.

(2) If, on an application under subsection (1), the court is satisfied that in respect of a corporation or any of its affiliates

(a) any act or omission of the corporation or any of its affiliates effects a result,

(b) the business or affairs of the corporation or any of its affiliates are or have been carried on or conducted in a manner, or

(c) the powers of the directors of the corporation or any of its affiliates are or have been exercised in a manner

that is oppressive or unfairly prejudicial to or that unfairly disregards the interests of any security holder, creditor, director or officer, the court may make an order to rectify the matters complained of.

114 The question here is whether the trial judge erred in concluding that the Monitor had standing to be a complainant. There are two elements to this analysis: can a monitor be a complainant under the *CBCA*; and should the Monitor have been a complainant in this case? I would answer both questions affirmatively.

115 As is clear from s. 238(d) of the *CBCA*, a court exercises its discretion in determining who may be a complainant, and this discretion is broad. There has been much jurisprudence on who qualifies as a complainant. In *Olympia & York*, a trustee in bankruptcy, acting on behalf of the creditors of the bankrupt estate, was entitled to be a complainant in an oppression action involving an oppressive agreement between the debtor and a non-arm's length party. As this court said in that case at para. 45:

> ...the trustee is neither automatically barred from being a complainant nor automatically entitled to that status. It is for the judge at first instance to determine in the exercise of his or her discretion whether in the circumstances of the particular case, the trustee is a proper person to be a complainant.

116 Admittedly, a monitor differs from a trustee in bankruptcy in that the latter represents the interests of the creditors whereas the monitor has a broader mandate. However, like a trustee in bankruptcy, a monitor is neither automatically barred from being a complainant nor automatically entitled to that status.

117 Section 241 speaks of *a* proper person, not *the* proper person, therefore allowing for discretion to be exercised in the face of more than one proper person. The appellants did not direct us to any authority saying that a monitor could not be a complainant. Paragraph 23(1)(k) of the *CCAA* expressly provides that a monitor shall carry out any functions in relation to the company that the court may direct. Moreover, s. 23(1)(c) directs a monitor to conduct any investigation that the monitor considers necessary to determine the state of the company's business and financial affairs. It does not strain credulity that this responsibility will frequently place a monitor at odds with the shareholders or other stakeholders.

118 Additionally, there is nothing in the *CCAA* itself to suggest that a monitor cannot be authorized to act as a complainant. Indeed, the broad language of s. 11 of the *CCAA*, which permits a supervising court to "make any order it considers appropriate in the circumstances", is permissive of such orders. As this court and the Supreme Court have made clear, the broad language of s. 11 "should not be read as being restricted by the availability of more specific orders": *U.S. Steel Canada Inc., Re*, 2016 ONCA 662, 39 C.B.R. (6th) 173, at para. 79, citing *Century Services*, at para. 70. Courts can, and sometimes should, make "creative orders" in the context of *CCAA* proceedings: *U.S. Steel*, at paras. 80, 86-87.

119 Generally speaking, the monitor plays a neutral role in a *CCAA* proceeding. To the extent it takes positions, typically those positions should be in support of a restructuring purpose. As stated by this court in *Ivaco Inc., Re* (2006), 83 O.R. (3d) 108 (C.A.), at paras. 49-53, a monitor is not necessarily a fiduciary; it only becomes one if the court specifically assigns it a responsibility to which fiduciary duties attach.

120 However, in exceptional circumstances, it may be appropriate for a monitor to serve as a complainant. In my view, this is one such case.

121 Here, in para. 37(c) of the Amended and Restated Initial *CCAA* Order dated November 20, 2015, the Monitor was directed to investigate whether there were potential related party transactions that should be reviewed. It then reported back to the supervising *CCAA* judge that there were, and on that basis the *CCAA* judge authorized the Monitor to commence proceedings under s. 241 of the *CBCA*. The Monitor proceeded with the oppression action in the interests of the restructuring consistent with the objectives of the *CCAA*. The trial judge ultimately found that aspects of the Port Transaction, such as the change of control clause in the Cargo Handling Agreement that gave Essar Global control over who can be a buyer of the Algoma business, were oppressive and also harmful to the restructuring process. The Monitor took the action as an "adjunct to its role in facilitating a restructuring".

122 Moreover, it cannot be said that the Monitor was a fiduciary. Indeed, the appellants did not say this in their pleadings, opening submissions, or closing submissions before the trial judge. The remedy granted by the trial judge was directed at the oppression and removed an insurmountable barrier to a successful restructuring. In addition, it was brought in the face of Essar Global demonstrating a continuous desire to acquire Algoma and, as evident from the letter sent by its counsel, a desire to discourage others from doing so.

123 It will be a rare occasion that a monitor will be authorized to be a complainant. Factors a *CCAA* supervising judge should consider when exercising discretion as to whether a monitor should be authorized to be a complainant include whether:

(i) there is a *prima facie* case that merits an oppression action or application;

(ii) the proposed action or application itself has a restructuring purpose, that is to say, materially advances or removes an impediment to a restructuring; and

(iii) any other stakeholder is better placed to be a complainant.

These factors are not exhaustive, and none of them is necessarily dispositive; they are simply factors to consider.

124 In the circumstances that presented themselves here, the *CCAA* supervising judge was justified in providing authorization. A *prima facie* case had been established; the Monitor had reviewed and reported to the court on related party transactions; the oppression action served to remove an insurmountable obstacle to the restructuring; and the Monitor could efficiently advance an oppression claim, representing a conglomeration of stakeholders, namely the pensioners, retirees, employees, and trade creditors, who were not organized as a group and who were all similarly affected by the alleged oppressive conduct.

125 Quite apart from meeting the aforementioned criteria, I would also observe that as the

presiding judge in the *CCAA* proceeding and the trial judge, Newbould J. had insight into the dynamics of the restructuring and was well positioned to supervise all parties including the Monitor to ensure that no unfairness or unwarranted impartiality occurred.

126 Lastly, I do accept the appellants' position that the *Nortel* proceedings relied upon by the trial judge in support of his conclusion were quite different from this case. In *Nortel*, the monitor's powers were expanded by an order authorizing the Monitor to exercise any powers properly exercisable by a Board of Directors of Nortel or its subsidiaries. But this expansion was a response to the resignations of the Boards of Nortel and its subsidiaries, not, as here, a response to the results of investigations the Monitor had been directed to pursue. That said, the case does illustrate the need to avoid rigid definition of a monitor's role and responsibilities.

127 In conclusion, I would not give effect to the appellants' submission that the trial judge erred in granting the Monitor standing to pursue an action for oppression.

(2) Derivative or Oppression Action

128 In addition to attacking the standing of the Monitor to bring the action, the appellants also submit that the Monitor was precluded from bringing the action in the form of an oppression remedy proceeding pursuant to s. 241 of the *CBCA*. In their view, the action could only have been brought as a derivative action pursuant to s. 239 of that *Act*. They say the claim asserted is a corporate claim belonging to Algoma, if anyone, and the stakeholders, on whose behalf the Monitor asserts the claim, were not harmed directly or personally but only derivatively through harm done to Algoma. I disagree.

129 In support of their submission, the appellants rely heavily on the decision of this Court in *Wildeboer*. This case is not *Wildeboer*, however.

130 In *Wildeboer*, "insiders" who controlled the corporation had misappropriated many millions of dollars from the corporation. The <u>sole claim</u> advanced by the complainant minority shareholder by way of oppression remedy was for the return of the misappropriated funds <u>to the corporation</u>. There was <u>no claim</u> asserted by the complainant, of any kind, <u>for a personal remedy *qua* shareholder</u>. As the court noted at para. 45, "[t]he substantive remedy claimed is the disgorgement of all the ill-gotten gains back to Martinrea [the corporation in question]."

131 The *Wildeboer* decision must be read in that context. It does not stand for the proposition that in all cases where there has been a wrong done to the corporation, the action must be brought as a derivative action. Consistent with a number of other authorities, this court expressly re-affirmed the principles that the derivative action and the oppression remedy are not mutually exclusive and that there may be circumstances giving rise to overlapping derivative actions and oppression remedies where harm is done both to the corporation and to stakeholders in their separate stakeholder capacities. This is clear from para. 26:

> I accept that the derivative action and the oppression remedy are not mutually exclusive. Cases like *Malata* [*Malata Group (HK) Ltd. v. Jung*, 2008 ONCA 111, 89 O.R. (3d) 36] and *Jabalee* [*Jabalee v. Abalmark Inc.*, [1996] O.J. No. 2609 (C.A.)] make it clear that there are circumstances where the factual underpinning will give rise to both types of redress and in which a complainant will nonetheless be entitled to proceed by way of oppression. Other examples include: *Ontario (Securities Commission) v. McLaughlin*, [1987] O.J. No. 1247 (Ont. H.C.); *Deluce Holdings Inc. v. Air Canada* (1992), 12 O.R. (3d) 131 (Ont. Gen. Div. [Commercial List]); *Covington Fund Inc. v. White*, [2000] O.J. No. 4589 (Ont. S.C.J.), aff'd [2001] O.J. No. 3918 (Ont. Div. Ct.); *Waxman v. Waxman*, [2004] O.J. No. 1765 (C.A.), at para. 526, leave to appeal refused, (2005), [2004] S.C.C.A. No. 291 (S.C.C.).

132 Or, as Armstrong J.A. put it in *Malata*, at para. 30:

> [T]here is not a bright line distinction between the claims that may be advanced under the derivative action section of the Act and those that may be advanced under the oppression remedy provisions.

133 In short, there will be circumstances in which a stakeholder suffers harm in the stakeholder's capacity as stakeholder, from the same wrongful conduct that causes harm to the corporation. In my opinion -- unlike in *Wildeboer*, where the harm alleged was solely harm to the corporation -- this case falls into the overlapping category.

134 For the purposes of this analysis, it is the nature of the claim put forward by the claimants, on whose behalf the Monitor was pursuing the oppression remedy, that must be examined. As the trial judge noted at para. 31, the Monitor initially cast quite widely the net of stakeholders affected by the Port Transaction and on whose behalf it was claiming a remedy. By the time of the hearing, however, the net's reach had been narrowed to Algoma's trade creditors, employees, pensioners, and retirees.

135 In oppression remedy parlance, the nub of the exercise lies in determining whether the claimant has identified a "reasonable expectation" and shown that it has been violated by wrongful conduct that is "oppressive" (in the broad sense contemplated by the *Act*) <u>of the interests of the claimant</u>: see *BCE*. The Monitor asserted at the hearing, and the trial judge found at para. 75:

> [T]hat the reasonable expectations of the trade creditors, the employees, pensioners and retirees of Algoma were that Algoma would not deal with a critical asset like the Port in such a way as to lose long-term control over such a strategic asset to a related party on terms that permitted the related party to veto and control Algoma's ability to do significant transactions or restructure and which gave unwarranted value to the third party.

136 It was alleged, and the trial judge found, that these reasonable expectations had been violated both by aspects of the Port Transaction itself, and by the change of control veto provided to Portco, and thus Essar Global, in the Port Transaction.

137 The appellants argue that the reasonable expectations asserted relate only to harm done to Algoma. The trial judge disagreed, as do I. As he concluded at para. 37:

> Aspects of the Port Transaction, such as the change of control clause in the Cargo Handling Agreement that gives the parent control over who can be a buyer of the Algoma business, are harmful to a restructuring process and negatively impact creditors. [Emphasis added]

138 On this basis, at para. 40, the trial judge distinguished *Wildeboer* because the Monitor was asserting "that the personal interests of the creditors ha[d] been affected."

139 The appellants place considerable emphasis on certain language contained in *Wildeboer* to the effect that, in circumstances where there may be overlapping derivative and oppression claims, the wrong must both harm the corporation and must also affect the claimant's "individualized personal interests". They interpret these comments as mandating not only that each claimant must suffer an identifiable individual harm but also that this harm must be different from other individualized personal harms suffered by others in their same class.

140 For example, the appellants rely on certain aspects of the following comments by this court at paras. 29, 32-33 of *Wildeboer*:

> On my reading of the authorities, in the cases where an oppression claim has been permitted to proceed even though the wrongs asserted were wrongs to the corporation, those same wrongful acts have, for the most part, also directly affected the complainant in a manner that was different from the indirect effect of the conduct on similarly placed complainants.
>
> ...
>
> The appellants are not asserting that their personal interests as shareholders have been adversely affected in any way other than the type of harm that has been suffered by all shareholders as a collectivity. Mr. Rea -- the only director plaintiff -- does not plead that the Improper Transactions have impacted his interest *qua* director.
>
> Since the creation of the oppression remedy, courts have taken a broad and flexible approach to its application, in keeping with the broad and flexible form of relief it is intended to provide. However, the appellants' open-ended approach

> to the oppression remedy in circumstances where the facts support a derivative action on behalf of the corporation misses a significant point: the impugned conduct must harm the complainant personally, not just the body corporate, *i.e.*, the collectivity of shareholders as a whole.

141 While pertinent to the *Wildeboer* context, some of the foregoing language, when read in isolation and out of context, may be misconceived when it comes to a more general application. However, I do not read *Wildeboer* as precluding an oppression remedy in respect of individuals forming a homogenous group of stakeholders -- for example, trade creditors, employees, retirees, or pensioners -- simply because each of them, separately, may have suffered the same type of individualized harm.

142 Instead, I read the reference at para. 29 to the complainant being directly affected "in a manner that was different from the indirect effect of the conduct on similarly placed complainants" to be another way of capturing the notion expressed in paras. 32-33 that the individualized harm is to be distinct from conduct harming only "the body corporate, *i.e.*, the collectivity of shareholders as a whole."

143 Were the appellants correct in their submissions, as counsel for the Monitor points out, this court would not have upheld an oppression remedy on behalf of <u>all</u> shareholders of a company that had suffered harm as a result of a non-market executive compensation contract: see *UPM-Kymmene Corp. v. UPM-Kymmene Miramichi Inc.* (2002), 214 D.L.R. (4th) 496 (Ont. S.C.J.) [Commercial List], aff'd (2004), 42 B.L.R. (3d) 34 (Ont. C.A.), at para. 153. Nor would it have upheld an oppression remedy claim on behalf of <u>a class</u> of shareholders who were harmed as a result of the existence of a transfer pricing regime that was disadvantageous to the company, as it did in *Ford Motor Company of Canada v. OMERS* (2006), 79 O.R. (3d) 81 (C.A.). *Wildeboer* contains no suggestion that these authorities are no longer good law; nor would it have done.

144 The same may be said, in my view, about a group of creditors who have suffered similar harm from a corporate wrong that affects both their interests as creditors and the interests of the corporation. While the oppression remedy is not available as redress for a simple contractual breach (such as the failure to pay a debt), it has long been held to be available, in appropriate circumstances, to creditors whose interests "have been compromised by unlawful and internal corporate manoeuvres against which the creditor cannot effectively protect itself": *J.S.M. Corp. (Ontario) Ltd. v. Brick Furniture Warehouse Ltd.*, 2008 ONCA 183, 41 B.L.R. (4th) 51, at para. 66. See also: *Fedel v. Tan*, 2010 ONCA 473, 101 O.R. (3d) 481, at para. 56.

145 The question is whether the impugned conduct is "oppressive" (in the broad sense contemplated by the *CBCA*) and, if so, whether the stakeholder has suffered harm in its capacity as a stakeholder as a result of that conduct.

146 Moreover, the circumstances that presented themselves emphasize the need for flexibility in the availability of the oppression remedy. The court and the Monitor were faced with *prima facie*

evidence of oppression including bad faith and self-dealing. There was *prima facie* evidence of personal harm to the pensioners, employees, retirees, and trade creditors. While leave of the court is required for a derivative action, in substance, in the context of a *CCAA* proceeding, court supervision is present, thereby neutralizing the need for the derivative action procedural safeguard of leave.

147 I would also note that GIP argues that the decision not to bring this action by way of derivative action may have been a strategic decision made because Algoma was contractually prohibited from seeking to set aside or vary the contracts arising from the Port Transaction, including the Cargo Handling Agreement and the lease. If anything, this argument supports the conclusion that it was appropriate for this action to be brought as an oppression claim.

148 In conclusion, at law, the Monitor was at liberty to bring an action for oppression. I will now turn to the issue of reasonable expectations.

(3) Reasonable Expectations

149 Essar Global and GIP submit that the trial judge erred in his analysis of reasonable expectations. They argue that there was no evidence of any subjectively held expectations, that the trial judge did not consider whether the expectations were objectively reasonable, and that he failed to consider factors identified in *BCE*.

150 The Monitor and Algoma respond by saying that the existence of reasonable expectations is a question of fact that can be proved by direct evidence or by the drawing of reasonable inferences. In this case, the trial judge properly considered the evidence that was before him to conclude that the pensioners, employees, retirees, and trade creditors held expectations that had been violated and that those expectations were objectively reasonable.

151 In his analysis, the trial judge correctly identified the two prongs of the oppression inquiry identified by the Supreme Court at para. 68 of *BCE*: (i) does the evidence support the reasonable expectation asserted by a claimant; and (ii) does the evidence establish that the reasonable expectation was violated by conduct falling within the terms "oppression", "unfair prejudice", or "unfair disregard" of a relevant interest?

152 In identifying these two prongs, at paras. 58-59, the Supreme Court made two preliminary observations:

> First, oppression is an equitable remedy. It seeks to ensure fairness -- what is "just and equitable". It gives a court broad, equitable jurisdiction to enforce not just what is legal but what is fair. ... It follows that courts considering claims for oppression should look at business realities, not merely narrow legalities.

> Second, like many equitable remedies, oppression is fact-specific. What is just and equitable is judged by the reasonable expectations of the stakeholders in the context and in regard to the relationships at play. Conduct that may be oppressive in one situation may not be in another. [Citations omitted.]

153 As also stated in *BCE* at para. 71:

> Actual unlawfulness is not required to invoke s. 241; the provision applies "where the impugned conduct is wrongful, even if it is not actually unlawful." The remedy is focused on concepts of fairness and equity rather than on legal rights. In determining whether there is a reasonable expectation or interest to be considered, the court looks beyond legality to what is fair, given all the interests at play.

154 Evidence of an expectation "may take many forms depending on the facts of the case": *BCE*, at para. 70. The "actual expectation of a particular stakeholder is not conclusive": *BCE*, at para. 62. Furthermore, a stakeholder's reasonable expectation of fair treatment "may be readily inferred", because fundamentally all stakeholders are entitled to expect fair treatment: *BCE*, at paras. 64, 70. Once the expectation at issue is identified, the focus of the inquiry is on whether it has been established that the particular expectation was reasonably held: *BCE*, at para. 70.

155 The Monitor particularized the reasonable expectations in issue. It stated that the stakeholders had reasonable expectations that the Essar Group would not cause Algoma to engage in transactions for their benefit to the detriment of Algoma and its stakeholders, cause Algoma to transfer long-term control over an irreplaceable and core strategic asset of Algoma (*i.e.* the Port) to the Essar Group, and, among other things, provide the Essar Group with a veto. The source and content of the expectations were stated by the Monitor to include commercial practice, the nature of Algoma, and past practice. These particulars would all feed an expectation of fair treatment.

156 Based on the reasonable expectations particularized by the Monitor, as already noted, the trial judge found at para. 75 that:

> [T]he reasonable expectations of the trade creditors, the employees, pensioners and retirees of Algoma were that Algoma would not deal with a critical asset like the Port in such a way as to lose long-term control over such a strategic asset to a related party on terms that permitted the related party to veto and control Algoma's ability to do significant transactions or restructure and which gave unwarranted value to the third party.

157 There was evidence of subjective expectations before the trial judge. For example, at para. 65 of his reasons, the trial judge considered the evidence of subjective expectations of two trade creditors explaining that they were unaware of the Port Transaction and would not have expected an outcome in which Algoma no longer had full control over the Port facility.

158 The trial judge also drew reasonable inferences from the evidence and circumstances that existed at Algoma in 2014 in support of the expectations relied upon by the Monitor, as he was entitled to do: see *Ford Motor*, at para. 65. In that regard, he noted that Algoma had gone through a number of insolvencies and restructurings since the early 1990s. Given the cyclical nature of the steel business, it was reasonable for the stakeholders to expect a restructuring in the future. The reasonableness of this restructuring-related expectation was confirmed by GIP's insistence on a "bankruptcy remote" structure for its loan "given the fluctuating prices of steel and Algoma's history of insolvencies", as GIP said in its factum.

159 Based on the evidence of subjective expectations and the reasonable inferences the trial judge drew from the record, it cannot be said that there was no evidence supporting the trial judge's conclusion that a future restructuring was not reasonably foreseeable.

160 The trial judge also concluded that it was objectively reasonable for the stakeholders to expect, as he noted at para. 73, that Algoma would not lose its ability to restructure absent the consent of Essar Global -- particularly in Sault Ste. Marie, where Algoma is the major industry on which trade creditors and employees rely. Put differently, it would not be reasonable to expect that the shareholder would have the right to veto any restructuring in a *CCAA* proceeding in which it was not an applicant and have the right to prefer its own interests over those of others such as the retirees, pensioners, trade creditors, and employees. Contrary to the assertions of the appellants, the trial judge expressly considered those issues.

161 Similarly, Essar Global submits that the foreseeability of another insolvency was contradicted by Mr. Marwah's affidavit evidence on the application for approval of the Plan of Arrangement, where he deposed that he believed that Algoma would be solvent. I would not give effect to this argument, as the trial judge's conclusion on the foreseeability of the insolvency is a factual finding, based on his review of the record as a whole. Essar Global has not demonstrated that this finding is subject to any palpable and overriding error.

162 The appellants' complaint that the trial judge failed to consider any of the factors identified in *BCE* is also misplaced. In that decision, the Supreme Court stated at para. 62:

> As denoted by "reasonable", the concept of reasonable expectations is objective and contextual. ... In the context of whether it would be "just and equitable" to grant a remedy, the question is whether the expectation is reasonable having regard to the facts of the specific case, the relationships at issue, and the entire context, including the fact that there may be conflicting claims and expectations.

163 Essar Global's argument that the trial judge did not turn his mind to the *BCE* factors ignores the trial judge's explicit reasons on this point. At para. 68 of his decision, the trial judge referred to the factors identified by the Supreme Court as "useful" in determining whether an expectation was reasonable. These factors include: i) general commercial practice; ii) the nature of the corporation; iii) the relationship between the parties; iv) past practice; v) steps the claimant could have taken to

protect itself; vi) representations and agreements; and vii) the fair resolution of conflicting interests between corporate stakeholders.

164 The trial judge correctly noted that, due to the fact-specific nature of the inquiry into reasonable expectations, not all listed factors must be satisfied in any particular case. I agree with his conclusion. The *BCE* factors are "not hard and fast rules", but are merely intended to "guide the court in its contextual analysis": Dennis H. Peterson and Matthew J. Cumming, *Shareholder Remedies in Canada*, 2nd ed. (Toronto: LexisNexis, 2017), at s.17.47.

165 Nonetheless, the trial judge did consider a number of the *BCE* factors based on the facts before him. For instance, at para. 68, he concluded that Algoma's prior sale of a non-critical asset, relating to factor iv), past practice, was not helpful in determining reasonable expectations. This was because the sale of a non-critical asset differs from the sale of a critical asset, as in the Port Transaction. Also under the rubric of past practices, he considered Algoma's prior insolvencies and restructuring proceedings. He concluded that while it was reasonable for stakeholders to expect that significant corporate changes might be necessary for Algoma in the future, it was not reasonable for them to expect that Algoma would lose its ability to restructure without the prior agreement of its parent, Essar Global.

166 As the trial judge's reasons reveal, he specifically considered the *BCE* factors and made findings on the objective reasonableness of the expectations at issue. I endorse the comments of the Monitor found at para. 80 of its factum:

> In this case, Justice Newbould found that the employees, retirees, and trade creditors all had a reasonable expectation that Essar Group would not engineer a transaction that deprived Algoma of a key strategic asset, rendering it incapable of restructuring or engaging in significant transactions without the approval of Essar Global, for minimal cash consideration in circumstances where there had been no consideration of alternative transactions. This was entirely supported by the entirety of the record adduced at trial.

167 This was essentially a factual exercise. There was conflicting evidence before the triaI judge. However it was for the trial judge to weigh the evidence and make factual findings. That is what he did. Based on the record before him, those factual findings were available to him. He considered both subjective expectations and whether the expectations were objectively reasonable. I see no reason to interfere.

168 I therefore reject the appellants' submissions on reasonable expectations.

(4) Wrongful Conduct and Harm

169 Essar Global also takes issue with the trial judge's conclusion that Essar Global's conduct was wrongful and harmful.

170 First, Essar Global submits that the trial judge inappropriately relied on the Equity Commitment Letter. It argues that the court approved the amended Plan of Arrangement that released Essar Global from any claim relating to the Equity Commitment Letter, and that reliance on a released obligation in connection with the wrongful conduct requirement of oppression was an impermissible collateral attack on the approval order.

171 I disagree. I can state no more clearly than the trial judge did at para. 100 of his reasons:

> The Monitor is not making a claim under the Equity Commitment Letter or asking that Essar Global provide the equity it agreed to provide in that commitment. Nor is the Monitor asking that the release be set aside. The Monitor contends, and I agree, that the failure of Essar Global to fund as agreed in the RSA and Equity Commitment Letter is a part of the factual circumstances to be taken into account in considering whether the affected stakeholders who were not party to the agreements were treated fairly by the Port Transaction.

172 An amended Plan of Arrangement became necessary when Essar Global did not provide the promised equity contribution, the roadshow presentations were unsuccessful, and the Port Transaction was the only available means to generate sufficient cash for Algoma.

173 I also note that the trial judge recognized that the trade creditors, the employees, pensioners and retirees were not parties to nor did they play any role in the amended Plan of Arrangement proceedings. Although the release was in both the original RSA and the amended RSA, it would appear that there was no express reference to the Port Transaction being part of the Plan of Arrangement, nor was there any mention of it in any endorsement or the order approving the amended Plan of Arrangement.

174 In addition, the trial judge did not make his finding of wrongful conduct based on Essar Global's breach of the Equity Commitment Letter. Rather, he found that the totality of Essar Global's conduct regarding the Recapitalization and Port Transaction satisfied the wrongful conduct requirement.

175 Taken in context, the trial judge made no error in his treatment of the release in favour of Essar Global.

176 Second, Essar Global submits that the trial judge made factual errors relating to Essar Global's cash contributions. In particular, it submits that he erred in concluding that the cash Essar Global did advance in the recapitalization, namely US$150 million rather than the US$250 to US$300 million that was originally promised, was generated by the Port Transaction when it was not. They also complain that he erred in granting an oppression remedy when the Equity Commitment Letter provided for a limited remedy in the event of a breach.

177 The reasons of the trial judge on Essar Global's cash contribution are admittedly somewhat

confusing. In para. 20 of his reasons, he states that Essar Global's revised cash contribution under the amended RSA was "to be funded largely not by Essar Global but by a loan from third party lenders to Portco of $150 million." Reading that paragraph in isolation might lend credence to the appellants' submission. That said, having regard to the record before him and reading the reasons as a whole, I am not persuaded that the trial judge misunderstood Essar Global's contribution to the recapitalization.

178 The relevant contributions made to Algoma in November 2014 consisted of:

* US$150 million in cash from Essar Global under the amended RSA;
* US$150 million in debt reduction in the form of loan forgiveness for certain loans owed by Algoma to members of the Essar Group under the amended RSA; and
* US$150 million in cash generated from the Port Transaction.

179 Essar Global only provided Algoma with US$150 million in cash equity, not the US$250 to 300 million in cash equity it had originally promised. The debt forgiveness would not assist Algoma in addressing its impending liquidity issues in the same way a cash injection would. Additionally, as the trial judge noted at para. 88, the US$150 million in debt reduction related to loans at the bottom of Algoma's capital structure, and therefore this reduction was of "questionable value" to Algoma at the time.

180 Algoma, the Monitor and Essar Global all provided the trial judge with written submissions describing the cash equity contribution as consisting of US$150 million in cash from Essar Global and US$150 million in cash from the Port Transaction. The contributions were also repeatedly referenced in the record. For example, the affidavit of Mr. Seifert -- which the trial judge considered in great detail -- clearly sets out Essar Global's cash contribution to Algoma and the US$150 million in cash paid by Portco to Algoma under the Port Transaction as separate transactions. Similarly, these contributions are described as separate transactions in the affidavits of Messrs. Marwah and Ghosh.

181 The trial judge's reasons establish that he understood that there were two separate cash payments made to Algoma -- one made by Essar Global in satisfaction of its commitments under the amended RSA and one made by Portco under the Port Transaction. He also understood that these cash payments were made in addition to Essar Global's forgiveness of US$150 million debt owed to it by Algoma.

182 Specifically, at para. 85, the trial judge noted that in October 2014, after the original RSA had been executed, Essar Global contemplated reducing the amount of its cash contribution

promised under the RSA and the Equity Commitment Letter. The roadshow presentation prepared regarding Algoma's capitalization showed that Essar Global proposed to contribute less than US$100 million of cash rather than the US$250-$300 million required. He obviously understood that there was to be a cash component to Essar Global's contribution separate and apart from the proceeds of the Port Transaction.

183 In addition, at para. 88, the trial judge noted that the Port Transaction "reduced the amount of cash equity previously promised by Essar Global to be advanced to Algoma" (emphasis added). This shows that the trial judge understood that the proceeds from the Port Transaction were not replacing Essar Global's promised cash contribution. The trial judge recognized that the cash equity contribution of US$150 million and the debt reduction of US$150 million were insufficient to successfully refinance Algoma, and using the Port Transaction proceeds was the only way to generate the additional US$150 million in cash necessary. The trial judge highlighted at para. 96 that Algoma's CEO, Mr. Ghosh, had indicated that "he had had to agree to the Port Transaction" as it was the "only way" to refinance Algoma, since Essar Global's contribution was only "bringing in $150 million".

184 Even if the appellants were correct in this regard, which I do not accept, on their analysis, they themselves admit that Essar Global's contribution was short by US$50 million.

185 No matter the correct figure, Essar Global's conduct created a situation where Algoma had no choice but to accept the Port Transaction. There was no palpable and overriding error in the trial judge's understanding of the recapitalization requirements.

186 In any event, the reduction in Essar Global's cash contribution was only one aspect of Essar Global's overall conduct considered by the trial judge. He did not conclude that the cash equity reduction was itself the oppressive act. Accordingly, again, any factual error regarding Essar Global's actual cash contribution was not a palpable and overriding error.

187 As mentioned, Essar Global also asserts that the remedy for breach contained in the Equity Commitment Letter precluded any oppression remedy. No one was suing for breach of the Equity Commitment Letter. Rather, it formed part of the context that included a failure to explore alternatives, the Port Transaction itself, control rights that were proffered as a disincentive to other bidders and that erased any possibility of a successful restructuring, all in disregard of the expectations of the pensioners, employees, retirees, and trade creditors.

188 Third, although not identified as a ground of appeal nor advanced as such in their factum, in oral argument, the appellants submitted that the alleged breach of the Equity Commitment Letter did not cause Algoma to enter the Port Transaction.

189 Essar Global contends that the trial judge made factual errors in finding a causal connection between Essar Global's equity commitment and the Port Transaction. It argues that the Port Transaction was a key component of the recapitalization before the execution of the Equity

Commitment Letter.

190 At trial, the trial judge rejected Essar Global's argument, finding at para. 87 that the Port Transaction was contemplated as a possible transaction when first introduced in May 2014, but that the transaction was not a certainty. He accurately noted that the first Plan of Arrangement that was approved by the Court required Essar Global to comply with its cash funding commitment of US$250 to US$300 million pursuant to the Equity Commitment Letter and that the Port Transaction was not a part of that plan. He found that the Port Transaction had to be carried out because of Essar Global's decision not to fund Algoma according to the terms of the Equity Commitment Letter.

191 The causal connection between Essar Global's equity commitment and the Port Transaction is a factual matter and the trial judge's factual finding was supported by the evidence.

192 Furthermore, the Port Transaction that was floated in May 2014 was an entirely different transaction, in which the proceeds of sale would flow upstream to Essar Global and would not be used to recapitalize Algoma. Moreover, the RSA prohibited a related party transaction without noteholder consent, and the proceeds of any sale in excess of US$2 million had to be used to reduce Algoma's debt.

193 I am not persuaded that the trial judge made any palpable and overriding error in his finding.

194 Fourth, Essar Global submits that the trial judge erred in disregarding the business judgment rule, which should have applied to prevent judicial second-guessing of the Board's decisions.

195 The trial judge correctly described the business judgment rule relying on para. 40 of *BCE*:

> In considering what is in the best interests of the corporation, directors may look to the interests of, *inter alia*, shareholders, employees, creditors, consumers, governments and the environment to inform their decisions. Courts should give appropriate deference to the business judgment of directors who take into account these ancillary interests, as reflected by the business judgment rule. The "business judgment rule" accords deference to a business decision, so long as it lies within a range of reasonable alternatives...It reflects the reality that directors, who are mandated under s. 102(1) of the *CBCA* to manage the corporation's business and affairs, are often better suited to determine what is in the best interests of the corporation. This applies to decisions on stakeholders' interests, as much as other directorial decisions.

196 Two additional points should be made with respect to the business judgment rule. First, the rule shields business decisions from court intervention only where they are made prudently and in good faith: *CW Shareholdings Inc. v. WIC Western International Communications Ltd.* (1998), 160 D.L.R. (4th) 131 (Ont. Gen. Div. [Commercial List]), at pp. 150-151.

197 Second, the rule's protection is available only to the extent that the Board of Directors' actions actually evidence their business judgment: *UPM-Kymmene*, at para. 153.

198 In deciding that the rule afforded no defence to Essar Global, the trial judge, at para. 123, relied on the fact that the Board did not follow "advice to go after Essar Global on its cash equity commitment". The trial judge went on to note that had Algoma's Board formed an independent committee in February 2014, events may have evolved differently, and the Board may have accepted the advice to hold Essar Global to its commitment.

199 Essar Global takes issue with this conclusion by asserting that the trial judge should not have characterized Algoma's Board as lacking independence because of its decision not to strike an independent committee. Essar Global points out that there was no evidence that Mr. Ghosh -- who cast the deciding vote in that decision -- was not free to vote as he chose.

200 Essar Global's argument ignores the trial judge's key finding that the four directors who voted against the independent committee in February 2014, including Mr. Ghosh, were not independent. The trial judge noted at para. 15 that he could "not overlook" that Mr. Ghosh had been with Essar Steel India, adding that Algoma's CFO, Mr. Marwah, had described these four directors as "Essar-affiliated directors". On this basis, it was open for the trial judge to find that the Essar-affiliated directors were not free from the influence of Essar Global and the Ruia family, particularly when considered alongside his extensive comments at paras. 43-60 finding that the critical decisions regarding Algoma's recapitalization and the Port Transaction were made not by Algoma's Board, but by Essar Global and Essar Capital as led by Mr. Seifert.

201 Specifically, the trial judge made findings of fact at paras. 51-53 regarding the limited role played by Algoma's Board and management. He accepted the evidence of Messrs. Ghosh and Marwah that they did not negotiate the economic terms of the debt refinancing or the Port Transaction. He also accepted the evidence of Mr. Ghosh that the Transaction was approved because there was no realistic alternative to generate sufficient cash to complete the recapitalization. He rejected the contradictory evidence of Mr. Seifert because the evidence of Messrs. Ghosh and Marwah was consistent with the documentary evidence. In my view, the trial judge was entitled to weigh the evidence as he did and make these findings of fact that were not infected by any palpable and overriding error.

202 Essar Global maintained before the trial judge, as they do before this court, that the Algoma Board's decisions were nonetheless shielded from court intervention because the Board had the benefit of sophisticated advisors throughout the recapitalization process. And yet, the only evidence tendered of any such advice was advice that the Board elected not to follow.

203 At para. 122, the trial judge described this advice, which was provided at least in part by Ray Schrock, described by the appellants as Algoma's lawyer. Mr. Schrock told the Board that unsecured noteholders would not react well to the Port Transaction and were likely to seek a higher infusion of cash from Essar Global, as promised in the Equity Commitment Letter. Mr. Schrock

said that the Board should insist that Algoma press Essar Global to fulfill its equity commitments. There was no evidence that steps were taken in this regard and the trial judge found that this advice was not followed.

204 Additionally, the circumstances surrounding the resignation of the independent directors from Algoma's Board lend support to the trial judge's conclusion that reliance on the business judgment rule was unavailable. Mr. Dodds' letter stated that his decision to resign was driven by his conclusion that as an independent director, he lacked confidence that he was "receiving information and engaged in decision-making in the same manner as those Board members who are directly affiliated with the company and/or its parent". It was open to the trial judge to reach the conclusions he did. In these circumstances, the business judgment rule was of little assistance.

205 Essar Global also submits that the trial judge should not have gone on to censure the activities of the Board in November 2014 (when the Board approved the transactions) by relying on the Board's February 2014 decision regarding the independent committee.

206 The trial judge did not censure the decisions of the Algoma Board solely based on the February 2014 meeting. The February meeting, and the events surrounding it, are part of a larger context that included the November 2014 meeting, all of which the trial judge considered, and all of which demonstrated that the Board's decisions regarding the recapitalization were not made prudently or in good faith, as found by the trial judge, and thereby failed to attract the application of the business judgment rule.

207 Specifically, the trial judge found at para. 123 that, if the Board had acquiesced to forming an independent committee, or listened to the truly independent directors before they resigned in frustration, subsequent steps taken in pursuit of the recapitalization transaction "may have been taken differently". He then went on to say that:

> What happened in the Port Transaction was an exercise in self-dealing in that Algoma's critical Port asset was transferred out of Algoma to a wholly owned subsidiary of Essar Global with a change of control provision that benefited Essar Global at a time that a future insolvency was a possibility.

208 Additionally, the trial judge found that the Board had accepted the inclusion of the contentious change of control provision in the Cargo Handling Agreement without considering alternatives. If the provision was truly for the benefit of GIP, it could have been accomplished in another way, without providing Essar Global with an effective veto over a change of control of Algoma.

209 All this evidence speaks to the Board's lack of business judgment and good faith, the failure to consider reasonable alternatives, and the Algoma Board's limited role in directing the recapitalization. There is no palpable and overriding error in the trial judge's conclusion that the Board was precluded from relying on the business judgment rule. His decision was amply supported

by the record.

210 Essar Global makes an additional point relating to the business judgment rule: that, in any event, no independent committee was required under corporate law.

211 It is a contrivance for Essar Global to impugn the trial judge's conclusion regarding the business judgment rule on the basis that an independent committee was not required. Although it is true that an independent committee was not legally or technically required, the Board's decision not to strike one, in the circumstances surrounding the November 2014 restructuring transactions, speaks volumes. The decision not to strike an independent committee must be considered alongside the evidence I have already reviewed: the Board's lack of independence, the Board's failure to follow its advisors' advice, the Board's failure to consider alternatives, and the Board's acquiescence to recapitalization transactions that primarily benefited the interests of Essar Global over those of Algoma. Again, the totality of the evidence supports the Board's lack of good faith, and renders the business judgment rule inapplicable.

212 There is one final argument Essar Global raises in invoking the business judgment rule. It claims that it was procedurally offensive for the trial judge to criticize the directors for not following Mr. Schrock's advice because evidence of the advice was not before him. It adds that, had the directors relied on legal advice from Mr. Schrock in the legal proceedings, privilege had not been waived.

213 Here, the minutes of the Board meeting held in November 2014 describe Mr. Schrock as "informing the Board [that] the [unsecured noteholders] would not react well to the proposed changes and that they were likely to push [Essar Global] for a higher infusion of cash/equity into [Algoma] as set forth in the Commitment [L]etter". Mr. Schrock also commented that the proposed Port Transaction "was likely to cause concern by the [unsecured noteholders]". Accordingly, Mr. Schrock advised the Board to "insist that [Algoma] should press all parties to fully satisfy their ... obligations regarding the equity contributions".

214 To the extent that Mr. Schrock's comments amounted to legal advice, I would first note that his advice was only one piece of the evidentiary puzzle in the broader factual context. Even if Mr. Schrock's advice, and the Board's failure to implement it, are disregarded, the record still amply supports the trial judge's conclusions on this issue.

215 I would also add that Essar Global's claim that the evidence of Mr. Schrock's advice was not before the trial judge is incorrect. The Board minutes were included in the record as an exhibit to an affidavit tendered by Essar Global. Finally, as for Essar Global's argument that privilege had not been waived, any privilege that may have attached to Mr. Schrock's advice belonged to Algoma and not Essar Global.

216 Fifth, Essar Global submits that the involvement of Algoma's management and Board in the Port Transaction sanitizes that transaction, because the trial judge concluded that Messrs. Ghosh and

Marwah acted in good faith thinking they were doing the best for Algoma in the circumstances. Essar Global also claims that the trial judge erred by holding otherwise because the Monitor failed to attack the Board's process in its pleading. I do not accept these arguments.

217 Despite Essar Global's argument, this court has established that good faith corporate conduct does not preclude a finding of oppression: *Brant Investments Ltd. v. KeepRite Inc.* (1991), 3 O.R. (3d) 289 (C.A.).

218 Moreover, Essar Global's argument on this point ignores the trial judge's findings that Algoma's Board and management played a limited role in the Port Transaction. It also ignores evidence that indicates that Messrs. Ghosh and Marwah's support was only given because there was no alternative to address Algoma's financial straits. This factual background demonstrates why it was open for the trial judge to conclude that the Port Transaction was oppressive, despite the good faith of Messrs. Ghosh and Marwah.

219 On the pleadings issue, I note that the Monitor pleaded that the Port Transaction was the result of Essar Global's "*de facto* control" of Algoma. In response, Essar Global pleaded that the Port Transaction was in the best interests of Algoma, based on the approval of the transaction by Algoma's Board and senior management, who were acting on an informed basis and with the benefit of financial advice. Given the way in which Essar Global framed its defence in its pleadings, it cannot now say that issues related to the Board's process were not properly before the trial judge.

220 Turning to the appellants' last argument relating to wrongful conduct and harm, they submitted that the trial judge identified two potential harms caused by Essar Global, neither of which is actionable in the oppression action: the undervalue of the Port Transaction to Algoma and the impairment of Algoma's ongoing restructuring.

221 In my view, it is inaccurate to characterize the trial judge's findings and analysis as concluding that harm flowed to stakeholders because the Port Transaction did not provide sufficient value to Algoma.

222 Specifically, he did not find that the US$171.5 million in consideration paid by Portco to Algoma constituted undervalue. Indeed his remedy that GIP be repaid in full suggests the contrary. Rather, he found that Essar Global received an unreasonable benefit from the Port Transaction.

223 Moreover, it was an exercise in self-dealing. As the trial judge stated at para. 144:

> For the balance of the first 20 years under the Cargo Handling Agreement after the GIP loan matures, if that agreement survives only to that date, Algoma will pay a further 12 years at $25 million, or $300 million, to Portco which will benefit Essar Global after the balance of the GIP loan is paid off. If the Cargo Handling Agreement is not terminated before the end of its life of 50 years, that will be another 30 years at $25 million, or $750 million, paid to Portco/Essar

> Global. Taken with the small amount paid by Essar Global, the $4.2 million in cash (and the $19.8 million note that it has refused to pay), it means that Essar Global will obtain an extremely large amount of cash from Algoma for little money. I realize that if Algoma became solvent and able to pay its debts, it would be able to pay a dividend to Essar Global (or the appropriate subsidiary) so long as Essar Global remained its shareholder. Whether and when Algoma could become solvent with its pension deficits that have existed for some time and be in a position to pay dividends to its shareholder is a significant unknown. But the payments under the Cargo Handling Agreement do not require any solvency test and are in the financial circumstances Algoma finds itself in, a clear contractual benefit for little money. It is an unreasonable benefit that was prejudicial to, and unfairly disregarded, the interests of the creditors on whose behalf this action has been brought by the Monitor.

224 The trial judge also concluded that the mismatched terms of the Cargo Handling Agreement (20 years renewable) and the 50-year lease offered Essar Global an additional benefit. In that regard, he was not bound to accept the evidence of the appellants' expert. He reasoned, at para. 142, that the Port was critical to Algoma's functioning, and therefore that Algoma would not be in a position to terminate the Cargo Handling Agreement for the duration of the lease:

> The other concerns are with respect to the obligations in the Cargo Handling Agreement. I have a concern with the imbalance in the term of the lease to Portco for 50 years against the term of the Cargo Handling Agreement for 20 years with automatic renewal for successive three year periods unless either party gives written notice of termination to the other party. If Essar Global thought that it wanted an increased payment after 20 years, it could refuse to continue the Cargo Handling Agreement and put Algoma at its complete mercy. If the market did not support an increased payment, or indicated that the payments from Algoma to Portco should be less in the future, Algoma would still be at the mercy of Essar Global. As the Port facilities are critical to the operation and survival of Algoma, it would be foolhardy indeed for Algoma to refuse to extend the Cargo Handling Agreement. The language in the Cargo Handling Agreement that Algoma can refuse to extend it after 20 years is illusory and not realistic. In reality, it is a provision that is one-sided in favour of Essar Global.

225 The change of control provision or veto was also an exercise in "self-dealing". The consent provision unnecessarily tied Algoma's strategic options to Essar Global. The trial judge properly found that the insertion of control rights in the Cargo Handling Agreement served no practical purpose to GIP and the same rights could have been provided for in the Assignment of Material Contracts.

226 As the trial judge concluded at para. 138:

> In my view, and I so order, the appropriate relief for the oppression involving the change of control clause in the Cargo Handling Agreement is to delete section 15.2 from that agreement and to insert a provision in the Assignment of Material Contracts agreement that if GIP becomes the equity owner of Portco, Algoma or its parent cannot agree to or undertake a change of control of Algoma without the consent of GIP.

227 There was evidence from Messrs. Ghosh and Marwah that supported the trial judge's conclusion that harm had flowed from the presence of the change of control provision and the ensuing letter from counsel. They were not cross-examined and no competing evidence was tendered by the appellants. It was also open to the trial judge to interpret the letter sent by Portco's counsel to Algoma's counsel as a veto threat to potential bidders while Essar Global continued to be interested in being a bidder. I would not give effect to this argument.

228 On the issue of the impairment of Algoma's ongoing restructuring, the appellants argue that no harm could have flowed from this, as the restructuring was not, in fact, impaired. Specifically, they argue that the only evidence of impairment consisted of statements in the affidavits of Messrs. Ghosh and Marwah that potential bidders for Algoma were concerned about the change of control clause. I would reject this argument as well. Again, I note that the appellants chose not to cross-examine on these affidavits, nor did they object to their admission into evidence. They cannot now, after the fact, impugn the trial judge's reliance on these statements.

229 Additionally, the appellants argue that it was premature for the trial judge to conclude that the control clause impaired the restructuring, because Portco/Essar Global was never asked to consent to a new transaction or to new owners. However, at para. 117, the trial judge noted that the change of control rights had to be considered alongside Essar Global's holding itself out as a prospective buyer in any bidding process for Algoma. That Essar Global has never been asked to consent to a new transaction was immaterial, as it remained in Essar Global's "interest to dissuade other buyers in order for it to achieve the lowest possible purchase price". In coming to this conclusion the trial judge pointed to the letter from counsel for Portco/Essar Global on May 12, 2016, which "sp[oke] volumes" by "clearly invit[ing] any bidder to understand that Essar Global has control rights."

230 I see no error in the trial judge's conclusion.

(5) The Remedy

231 Turning then to the issue of the remedy. Essar Global submits that the trial judge erred in striking out the control clause in the Cargo Handling Agreement and in granting Algoma the option of terminating the Port agreements upon repayment of the GIP loan. They argue that he was only permitted to rectify the harm that was suffered. Deleting the provision was an overly broad remedy that was unconnected to the reasonable expectations of the stakeholders and instead, he should have considered a nominal damages award.

232 GIP supports the submissions of Essar Global. It argues that the remedy awarded was not sought by any party, no evidence had been called in respect of that remedy, and no submissions were made. The practical effect of granting Algoma a termination right is that GIP does not have the security for which it bargained and it was prejudiced, despite its lack of involvement in the oppression found against Essar Global. GIP also argues that the Monitor and Algoma are seeking to set-off amounts owed by Essar Capital to Algoma against amounts owed to GIP, which results in additional prejudice.

233 I would not give effect to these submissions. First, trial judges have a broad latitude to fashion oppression remedies based on the facts before them. Once a claim in oppression has been made out, a court may "grant any remedy it thinks fit": *Pente Investment Management Ltd. v. Schneider Corp.* (1998), 42 O.R. (3d) 177 (C.A.), at para. 4. The focus is on equitable relief, and deference is owed to the remedy granted: *Fedel*, at para. 100.

234 Second, the trial judge properly identified the need to avoid an overly broad remedy, stating at para. 136 that there were "less obtrusive ways" of remedying the oppression than ordering shares of Portco be transferred to Algoma (the remedy the Monitor had originally requested). Varying the transaction as he did was one such way. The trial judge's remedy removes Portco's control rights (the main obstacle to a successful restructuring) and, after GIP is paid, restores the Port to the ownership of Algoma. If GIP becomes the equity owner of Portco, its consent will be required to any change of control. Unlike a damages award, the remedy was responsive to the oppressive conduct. It served to vindicate the expectations of the stakeholders that Algoma would retain long-term control of the Port and that Essar Global would not have a veto over its restructuring efforts.

235 Third, the remedy granted preserves the security GIP had bargained for and therefore GIP has not suffered any prejudice as a result of the remedy. The trial judge's remedy, as described at para. 145, ensures that GIP is to be paid in full. Until "payment in cash of all amounts owing to GIP" is made, the Port remains in Portco's hands and the contractual remedies held by GIP to enforce its security remain in place. Moreover, Essar Global guaranteed Portco's liabilities to GIP under GIP's loan in the Port Transaction, which further demonstrates GIP's lack of prejudice. As GIP's own affiant indicated, this guarantee provides GIP with "an extra layer of protection in the event the debtor is unable to repay the loan".

236 Finally, regarding the issue of set-off, I note that the arguments made by GIP in support of this ground were made prior to Newbould J.'s subsequent ruling dealing with this issue. In that decision, he held that Algoma had set-off amounts owed under the promissory note against Essar Global, but he preserved GIP's right to repayment. This decision is a full answer to GIP's arguments on this point, and ensures that GIP will not suffer any prejudice as a result of the remedy granted in response to Essar Global's oppressive conduct.

(6) Was There Procedural Unfairness?

237 Essar Global submits that the trial judge erred in basing his decision and relief on bases that were not pleaded. GIP supports the position of Essar Global, with particular focus on the remedy that was ultimately imposed.

238 As mentioned, the trial judge was the supervising *CCAA* judge and deeply acquainted with the facts of the restructuring. Of necessity, and on agreement of all parties to the oppression action, the timelines for pleadings, productions, and examinations were truncated. Additionally, no party objected at trial that the process had been procedurally unfair. Given the context and the complexity of the dispute, the pleadings were not as clear as they might have been in a less abbreviated schedule. That said, on a review of the record, I am not persuaded that there was any procedural unfairness with respect to the claims or that the appellants did not know the case they had to meet.

239 The focus of at least GIP's complaint lies in the remedy. The appellants are correct that the precise remedy awarded by the trial judge was not pleaded. A trial judge must fashion a remedy that best responds to the oppressive conduct and that is not overly broad. While it is desirable for a party seeking oppression relief to provide particulars of the remedy, a trial judge is not bound by those particulars. Because the discretionary powers under the oppression remedy must be exercised to rectify the oppressive conduct complained of (see: *Naneff v. Con-Crete Holdings Ltd.* (1995), 23 O.R. (3d) 481 (C.A.), at para. 27), it follows that the remedy will, by necessity, be linked to the oppressive conduct that was pleaded. Therefore a party against whom a specifically-tailored oppression remedy is ordered cannot fairly complain that the remedy caught them by surprise. This conclusion is consistent with *Fedel*, where this court upheld oppression remedies imposed by the trial judge where the relief granted had not been specifically pleaded or sought in argument.

240 Moreover, absent error, a trial judge's decision on remedy is entitled to deference. As I have discussed, there is an absence of error. Furthermore, in this case, there is no prejudice to GIP. Its position is preserved by the remedy granted by the trial judge. At the same time, the remedy is responsive to Essar Global's oppressive conduct.

241 That said, the trial judge did consider whether Essar Global and GIP could fairly argue that they were taken by surprise by his remedy. At para. 141, he rejected this position, holding that the issue of the change of control clause was pleaded by the Monitor, and affidavit material filed by both Essar Global and GIP provided evidence on the provision's significance. At para. 146, he concluded that issues relating to the relief he ordered were "fully canvassed in the evidence and argument", and that the remedy he ordered in fact was less intrusive than the remedy originally pled by the Monitor. And although he did not think an amendment was necessary, he nonetheless ordered that the Monitor would be granted leave to amend its claim to support the relief he granted.

242 I would not give effect to this ground of appeal.

(7) Fresh Evidence

243 Essar Global seeks to introduce fresh evidence on appeal that addresses the independence of

Algoma's Board of Directors. It takes the position that the trial judge's rejection of the independence of two directors, Messrs. Kothari and Mirchandani, played a significant role in his decision. It adds that the lack of independent directors was not pleaded by the Monitor and so Essar Global had no reason to adduce this evidence earlier.

244 Messrs. Mirchandani and Kothari joined Algoma's Board in June and August 2014, respectively, after the three independent directors resigned. They were therefore on the Board when the Port Transaction was approved in November 2014.

245 Whether "a proper case" exists to allow fresh evidence is determined by applying the test outlined in *R. v. Palmer*, [1980] 1 S.C.R. 75, or the slightly modified test from *Sengmueller v. Sengmueller* (1994), 18 O.R. (3d) 208 (C.A.).

246 As this court has noted, the two tests are quite similar: see *Chiang (Re)*, 2009 ONCA 3, 93 O.R. (3d) 483, at para. 77. Under the *Palmer* test, the party seeking to admit fresh evidence must demonstrate that the evidence could not, by due diligence, have been adduced at trial; that the evidence is relevant in that it bears on a decisive issue in the trial; that the evidence is credible; and that the evidence, if believed, could be expected to affect the result.

247 Under the *Sengmueller* test, the moving party must demonstrate that the evidence could not have been obtained by the exercise of reasonable diligence prior to trial; that the evidence is credible; and that the evidence, if admitted, would likely be conclusive of an issue on appeal.

248 Essar Global has failed to meet either the *Palmer* or the *Sengmueller* test for two main reasons.

249 In both its original and its amended statement of claim, the Monitor alleged that representatives of Essar Global were members of Algoma's Board and exercised *de facto* control over Algoma, such that they made decisions for the benefit of Essar Global while unfairly disregarding the interests of Algoma's stakeholders. Essar Global cannot claim to have been caught by surprise by the issue of the Board's independence being in play. The fresh evidence could have been obtained with reasonable diligence prior to trial.

250 In any event, the evidence would not have affected the result at trial, and is not conclusive of any issue on appeal. The fresh evidence Essar Global asks to proffer consists of the affidavit of Mr. Mirchandani, which states that he and Mr. Kothari were determined to be independent Board members as a result of a conflict of interest policy and by virtue of the questionnaires they each completed.

251 However, there was evidence before the trial judge essentially to this effect, including Algoma's October 2014 offering memorandum, which stated that the Board included two independent directors. Indeed, the trial judge commented on this evidence in footnote 7 of his reasons, and rejected it in concluding that Messrs. Mirchandani and Kothari were not truly

independent of Essar Global.

252 Additionally, and as I have already discussed elsewhere in these reasons, the remainder of the record strongly supported the Board's lack of independence. Even if the trial judge had Mr. Mirchandani's affidavit before him, it would not have made a difference.

253 I would therefore dismiss the motion for fresh evidence.

(8) Costs

254 GIP claimed costs of CDN$750,156.18 against the Monitor payable on a partial indemnity scale. It claimed it was entirely successful because it successfully resisted relief sought by the Monitor that would have prejudiced GIP. The trial judge exercised his discretion and observed that success between the Monitor and GIP was divided. He also relied on GIP's appeal as a basis to conclude success was divided. He therefore did not order any costs in favour of or against GIP.

255 GIP seeks leave to appeal the trial judge's costs award. Before this court, GIP in essence renews the arguments made before the trial judge. The awarding of costs is highly discretionary and leave is granted sparingly. I see no error in principle in the trial judge's exercise of discretion nor was the award plainly wrong: *Hamilton v. Open Window Bakery Ltd.*, 2004 SCC 9, [2004] 1 S.C.R. 303, at para. 27.

256 At trial, GIP was unsuccessful in challenging both the Monitor's claim of standing and its claim that the Port Transaction was oppressive. It also seems incongruous for GIP to suggest that it was entirely successful in defeating the Monitor's claims, while it appeals the trial decision.

257 I see no basis on which to interfere with the costs award of the trial judge and would refuse leave to appeal costs.

E. DISPOSITION

258 For these reasons, I would dismiss the appeal, the motion for fresh evidence and the motion for leave to appeal costs.

259 As agreed, I would order that the Monitor and Algoma are entitled to costs of the appeal fixed in the amounts of CDN$100,000 and CDN$60,000 respectively, inclusive of disbursements and applicable taxes on a partial indemnity scale. At the oral hearing, the parties had not agreed on whether the award should be payable on a joint and several basis and requested more time to consider the matter. On September 15, 2017, counsel wrote advising that they had still not agreed on this issue. GIP requested the opportunity to make additional costs submissions on this issue at the appropriate time. Under the circumstances, I would permit GIP to make brief written submissions on this issue by January 10, 2018. Essar Global shall have until January 17, 2018 to file its submissions. The Monitor and Algoma shall have until January 24, 2018 to respond.

S.E. PEPALL J.A.
R.A. BLAIR J.A.:-- I agree.
K.M. van RENSBURG J.A.:-- I agree.

1 Algoma was named in the proceeding below as a defendant, but supports the position taken by the respondent, Ernst & Young Inc. It is therefore a respondent on this appeal.

2 In early 2015, Essar Consulting obtained two additional valuations of the Port assets, one in February from Royal Bank of Canada and one in April from ICICI Securities. The RBC valuation, which was an exhibit to the affidavit of Joseph Seifert, was between US$165 and US$200 million. The ICICI valuation, which was an exhibit to the affidavit of Anshumali Dwivedi, was US$349 million.

3 Although Deutsche Bank intervened in the proceedings below, it was not involved in this appeal.

4 Before this court, no submissions on urgency were advanced.

5 Stephanie Ben-Ishai and Catherine Nowak, "The Threat of the Oppression Remedy to Reorganizing Insolvent Corporations" in Janis P. Sarra, ed., *Annual Review of Insolvency Law, 2008* (Toronto: Carswell, 2009) 429, at pp. 430-431 and 436.

6 Janis Sarra, "Creating Appropriate Incentives, A Place for the Oppression Remedy in Insolvency Proceedings" in Janis P. Sarra ed., *Annual Review of Insolvency Law, 2009* (Toronto: Carswell, 2010) 99, at p. 99.

TAB 6

Intitulé de la cause :

Armoires de cuisine de Montréal ltée (Re)

DANS L'AFFAIRE DE LA FAILLITE DE : ARMOIRES DE CUISINE DE MONTRÉAL LTÉE, débitrice
et
PERRAS, FAFARD, GAGNON INC., en sa qualité de syndic aux biens de la débitrice, requérante
et
LES ENTREPRISES PARÉ INC., MAURICE PARÉ, ROBERT PARÉ et SERGE PARÉ, intimés

[1983] J.Q. no 192

No : 500-11-003013-790

Cour supérieure du Québec
District de Montréal

L'honorable Brendan O'Connor, J.C.S.

le 26 avril 1983.

(30 paragr.)

Avocats :

Pierre Bourque, procureur de la requérante.
Jean-Yves Fortin, procureur des intimés.

JUGEMENT

1 LA COUR, ayant entendu les parties par leur procureurs respectifs, ayant examiné les procédures, la preuve au dossier et sur le tout délibéré, rend le jugement suivant :

2 This is a petition by the trustee of the estate of the debtor company. The trustee's corporate name has been changed to Raymond, Chabot, Fafard et Gagnon Inc. since the institution of these proceedings. The petition seeks a reimbursement of a dividend paid by the bankrupt company. The trustee alleges that this payment to Les Entreprises Paré Inc. of 355 000 $ was made illegally and without consideration under the following circumstances.

3 Prior to the events hereinafter related, two Quebec families, the Paré family and the Bergevin family, related by marriage to each other, owned through their respective holding companies (Les Entreprises Paré Inc. and M.P.A. Ltée) all the issued shares of the bankrupt company. The shares were owned in approximately equal amounts but the Bergevin family owned slightly more shares than the Paré family, holding approximately 52 % of the issued shares and the Paré family holding the remaining 48 %.

4 The business (the manufacture and sale of kitchen cabinets) had been carried on with success for several years and there had not been any serious differences between these joint shareholders. However, serious financial difficulties began to arise as early as 1976 and 1977. These can best be explained by quoting from a letter dated 5 October 1978, (Exhibit R-12) written by the company's then principal financial officer, Mr. Jacques Orphanos, to RoyNat Ltée which held as security for its advances to the company bonds issued under a trust deed.

> "Le secteur des ventes, se disant dans l'impossibilité de tenir compte des hausses du prix des matières premières, parfois dû à la rareté (exemple : chêne), à une augmentation du coût de la main d'oeuvre, et des frais d'administration, accepta de signer des commandes à des prix variant entre 7 % et 15 %, en bas du prix de liste courant. Ce qui eu pour effet, au cours du présent exercice financier, d'occasionner une baisse de revenus d'au moins 300 000,00 $.
>
> Au début du mois d'avril 1978, suite à l'étude du résultat des opérations, nous en sommes venus à la conclusion qu'advenant le cas, où cette situation demeurerait, nous aurions à subir des pertes considérables. Nous avons pris la décision d'augmenter nos prix de ventes d'au moins 20 %, de visiter nos principaux compétiteurs afin de les aviser de notre décision, et de les convaincre de la nécessité de poser un tel geste.
>
> Ce qui a eu pour effet, qu'actuellement nous en sommes au point mort, et espérons réaliser à nouveau des profits raisonnables, dans une période n'excédant pas 120 jours d'aujourd'hui."

5 In view of these setbacks, some dissatisfaction arose between the two family groups and a desire was expressed that only one of the groups should become the owner of all the outstanding shares of the company, thus acquiring complete authority to make all the decision in the

management of the company.

6 To this end, certain earlier offers were made for the sale of the shares but without success. However, the following plan was conceived to enable the Paré group to obtain complete control by the acquisition of the 52 % majority holding of the Bergevin group.

7 Through an arrangement with the company's banker, the Bank of Nova Scotia, a temporary advance (bridge financing) was arranged whereby the company obtained a demand loan from the bank of 355 000 $, being the agreed sale price of the shares in question. The debtor company through its then directors, all members of the said families, then agreed with RoyNat Ltée to issue debentures under a trust deed whereby earlier debentures were refinanced together with an additional financing of 349 390 $ representing "fonds de roulement". This sum was used, principally, to repay the bank for the bridge financing and, at the same time, to declare a dividend of 355 000 $ payable to Les Entreprises Paré Inc., (the holding company of the Paré family) which had become the sole shareholder of the debtor company by its acquisition under the same transaction of the remaining outstanding shares (52 %) heretofore held by M.P.A. Ltée, the holding company of the Bergevin family.

8 All this will be clearly demonstrated by listing and describing the relevant dates and events most of which took place within the year prior to the voluntary assignment made by the company in the hands of the trustee on November 21, 1979.

13 September 1978 -	Accepted Offer to Purchase addressed jointly to Jean-Paul Bergevin, Madame Berthe Bergevin and M.P.A. Ltée, of all their shares in Armoires de Cuisine de Montréal Ltée, the said offer having been made by Les Entreprises Paré Inc. over the signature of Maurice Paré as president who also signed in a personal capacity : the price stipulated was 1 750 $ per share for 205 shares. (Exhibit R-9)
13 November 1978 -	"Offre de financement" from RoyNat Ltée addressed to Armoires de Cuisine de Montréal Ltée. (Exhibit R-10)
4 December 1978 -	Minute book entry showing transfer from M.P.A. Ltée of 203 shares of Armoires de Cuisine de Montréal Ltée to Les Entreprises Paré Inc.
4 December 1978 -	Cheque drawn on the Banque Canadienne Nationale issued by Les Entreprises Paré Inc. in the sum of 355 484,93 $ payable to the Bank of Nova Scotia. (Exhibit R-8)

27 February 1979 -	Trust deed executed by the debtor company in favour of Canada Trust charging the assets of the debtor company and authorizing the issue of debentures in the sum of 975 000 $.
7 March 1979 -	Cheque drawn on the Bank of Nova Scotia issued by Armoires de Cuisine de Montréal Ltée in the sum of 355 000 $ payable to Les Entreprises Paré Inc. (Exhibit R-1)
31 March 1979 -	The following journal entries were made in the books of the company :

1) Bénéfices non reportés - 355 000,00 Avances Les Entreprises Paré Inc. - 355 000,00
2) Frais de finance reportés - 3 337,00 Frais de financement - 3 337,00 (Exhibit R-16)

11 October 1979 -	The Bank of Nova Scotia, the debtor company's banker, took possession of inventories and accounts receivable exercising their rights under the security documents held by that bank.
1 November 1979 -	Canada Trust, acting for the bondholder under the above mentioned trust deed, took possession of all the moveables and immoveables of the debtor company.
21 November 1979 -	Assignment made to the official receiver by the debtor company for the general benefit of its creditors.

14-20 August 1980 - Service of the present petition upon the respondents.

9 Section 79 and section 78 of the Bankruptcy Act are relatively new provisions, having been added as amendments to the Act only on July 11, 1966. For that reason, they have not been applied or interpreted by the Courts to any great extent and it will therefore be helpful to set forth the full text of these sections in the present judgment. Section 79 reads as follows :

> (1) Where a corporation that is bankrupt has within twelve months preceding its bankruptcy paid a dividend, other than a stock dividend, or redeemed or purchased for cancellation any of the shares of the capital stock of the corporation, the court may on the application of the trustee, inquire into whether the dividend was paid or the shares redeemed or purchased for cancellation at a time when the corporation was insolvent, or whether the payment of the dividend or the redemption or purchase for cancellation of

its shares rendered the corporation insolvent.

(2) Where the court in proceedings under this section finds that the payment of the dividend, or the redemption or purchase of shares, described in subsection (1) was made at a time when the corporation was insolvent or rendered the corporation insolvent, the court may give judgment to the trustee,

a) against the directors of the corporation, jointly and severally, in the amount of such dividend or redemption or purchase price, with interest thereon, as has not been repaid to the corporation, and

b) as against a shareholder who is related to any one or more directors or to the corporation, or who is a director described in subsection (3), in the amount of such dividend or redemption or purchase price, and the interest thereon, as was received by the shareholder and not repaid to the corporation.

(3) A judgment pursuant to paragraph (a) of subsection (2) shall not be entered against or be binding on a director who had, in accordance with any applicable law governing the operation of the corporation, protested against the payment of the dividend or the redemption or purchase for cancellation of the shares of the capital stock of the corporation and had thereby exonerated himself under such law from any liability therefor.

(4) Nothing in this section shall be construed to affect any right, under any applicable law governing the operation of the corporation, of the directors to recover from a shareholder the whole or any part of any dividend, or any redemption or purchase price, made or paid to the shareholder when the corporation was insolvent or that rendered the corporation insolvent.

(5) For the purposes of an inquiry under this section, the onus of proving that the corporation was not insolvent when a dividend was paid or shares were redeemed or purchased for cancellation or that the payment of a dividend or a redemption of shares did not render the corporation insolvent lies upon the directors and the shareholders of the corporation.

10 Now, in addition to the trustee's claim that the respondents should be condemned to reimburse it for the dividend paid because of the alleged infringement of the provisions of the above section 79, the trustee urges that, in any event it has an alternative recourse. It alleges that the respondents have acted illegally, thus rendering the said payment null and without consideration.

11 This alternative prayer in the trustee's petition is phrased as follows :

> "Et alternativement, DÉCLARER nul, illégal, sans droit et fait sans considération le paiement de 355 000,00 $ à Les Entreprises Paré Inc.;
>
> CONDAMNER, conjointement et solidairement, les intimés à rembourser cette somme de 355 000,00 $ avec les intérêts y afférent, au taux approprié, et avec tous les dépens."

12 As a general basis for this latter conclusion, the trustee points to Article 989 of the Civil Code of Quebec which reads as follows :

> "A contract without a consideration, or with an unlawful consideration has no effect; but it is not the less valid though the consideration be not expressed or be incorrectly expressed in the writing which is the evidence of the contract."
>
> "Le contrat sans considération, ou fondé sur une considération illégale, est sans effet; mais il n'est pas moins valable quoique la considération n'en soit pas exprimée ou soit exprimée incorrectement dans l'écrit qui le constate."

13 The trustee could well have added, of course, the next Article of the Code (Article 990) which states when the consideration of a contract is to be considered illegal. That article reads as follows :

> "The consideration is unlawful when it is prohibited by law, or is contrary to good morals or public order."
>
> "La considération est illégale quand elle est prohibée par la loi, ou contraire aux bonnes moeurs ou à l'ordre public."

14 In urging this alternative conclusion, the trustee in paragraph 8 of his petition alleges the following :

> "En grevant les actifs de la compagnie d'une charge additionnelle en faveur de RoyNat Ltée et utilisant le produit de cet emprunt pour permettre l'acquisition par Les Entreprises Paré Inc. de toutes les actions souscrites et émises de la corporation débitrice, les intimés ont posé un geste illégal, rendant ce paiement nul et sans considération."

15 In my opinion, the above allegation in the motion and its alternative conclusion are wide enough by their terms to constitute a claim based upon section 78 of the Bankruptcy Act which reads as follows :

> (1) "Where a person who has sold, purchased, leased, hired, supplied or

received property or services in a reviewable transaction becomes bankrupt within twelve months of the transaction, the court may, upon the application of the trustee, inquire into whether the bankrupt gave or received, as the case may be, fair market value in consideration for the property or services concerned in the transaction.

(2) Where the court in proceedings under this section finds that the consideration given or received by the bankrupt in the reviewable transaction was conspicuously greater or less than the fair market value of the property or services concerned in the transaction, the court may give judgment to the trustee against the other party to the transaction, or against any other person being privy to the transaction with the bankrupt, or against all such persons, for the difference between the actual consideration given or received by the bankrupt and the fair market value, as determined by the court, of the property or services concerned in the transaction.

(3) In making an application under this section the trustee shall state what in his opinion was the fair market value of the property or services concerned in the transaction and what in his opinion was the value of the actual consideration given or received by the bankrupt in the transaction, and the values on which the court makes any finding pursuant to this section shall be the values so stated by the trustee unless other values are proven."

(1) "Lorsqu'une personne qui a vendu, acheté, loué, engagé, fourni ou reçu des biens ou des services au moyen d'une transaction révisable fait faillite dans les douze mois qui suivent la transaction, le tribunal peut, à la demande du syndic, enquêter pour déterminer si le failli a donné ou reçu, selon le cas, une juste valeur du marché en contrepartie des biens ou services sur lesquels porte la transaction.

(2) Lorsque le tribunal, dans des instances en vertu du présent article, constate que la contrepartie donnée ou reçue par le failli dans la transaction révisable était manifestement supérieure ou inférieure à la juste valeur du marché des biens ou services sur lesquels portait la transaction, il peut accorder au syndic un jugement contre l'autre partie à la transaction ou contre toute autre personne ayant intérêt à la transaction avec le failli ou contre toutes ces personnes, pour la différence entre la contrepartie réellement donnée ou reçue par le failli et la juste valeur du marché, telle qu'elle est déterminée par le tribunal, des biens ou services sur lesquels porte l'opération.

(3) En présentant une demande prévue par le présent article, le syndic doit déclarer quelle était à son avis la juste valeur du marché des biens ou services en cause dans la transaction et quelle était à son avis la valeur de la contrepartie véritable donnée ou reçue par le failli dans la transaction, et

les valeurs sur lesquelles le tribunal rend une décision en conformité du présent article doivent être les valeurs ainsi déclarées par le syndic, sauf si la preuve d'autres valeurs est établie."

16 One might first question whether section 78 should be considered to have application in the present case. This new section was enacted in 1966 at the same time as section 79, (14-15 Elizabeth II, chapter 32, section 12). Indeed, in that Act to amend the Bankruptcy Act, two new sections alone formed part of section 12 of the amending statute and were given the numbers 67A and 67B of the Act. By the revision of the Bankruptcy Act in 1970, these two sections became 78 and 79 respectively It has been said that of these two "reviewable transactions", section 78 deals with goods and services and section 79 deals with dividends and redemption of shares. (See the decision of Moisan J. in re Tremblay; Gingras, Robert, Marcoux Ltée v. Beaudry and Paradis (1981) 36 C.B.R. (N.S.) 111)

17 But, on the other hand, there are other significant differences between the two sections which support a view that there could be a dual application of them in the present case. Not the least of these is that there is nothing in section 78 as there is in section 79 which says that "the disposal of an asset of a company must be made at a time when the company is insolvent or made in such a manner as to contribute to the insolvency before that asset can be recovered by the trustee". These were the very words used by Hart J.A. of the Nova Scotia Supreme Court (Appeal Division) in Clarkson Company Limited v. White, Bower and Bower, Hessian & Assoc. Company Limited, (1980) 32 C.B.R. (N.S.) 25.

18 The following excerpts from the reasons for judgment given by Mr. Justice Hart in the above-mentioned decision will be helpful in determining the application of section 78 to the present case. At page 34 he stated :

> "In my opinion s. 78 of the Bankruptcy Act was intended to permit the trustee to have reviewable transactions between the bankrupt and persons not dealing at arm's length made within one year of the bankruptcy without adequate consideration set aside. Once all of the conditions have been established as required by the legislation then, although the remedy is in the permissive form, the court has a duty to grant some judgment against any or all of the persons named in the section so that an asset improperly removed from the company may be restored for the benefit of its creditors...
>
> It is up to businessmen, knowing this, to avoid making gifts or transfers without consideration to related persons...
>
> One of the purposes of the Bankruptcy Act is to prevent the transfer of assets of a bankrupt to related persons during the year prior to the bankruptcy without

> adequate consideration, and when such a transaction has been established it is, in my opinion, the duty of the judge presiding at the hearing to enable the trustee to recover the value of the asset for the benefit of creditors, and judgment should be given accordingly.
>
> There is nothing in s. 78, as there is in s. 79, which says that the disposal of an asset of the company must be made at a time when the company is insolvent or made in such a manner as to contribute to the insolvency before that asset can be recovered by the trustee. The only qualification is that the asset be disposed of without consideration to a related person within 12 months immediately prior to the bankruptcy...
>
> Once the trustee has shown the court that the transaction falls within the prohibition of s. 78, it is, in my opinion, the duty of the trial judge to give judgment against the related company or against the directors, as being privy to the transaction, or against both."

19 As I have above indicated, the evidence adduced in the present case disclosed that a "reviewable transaction" had taken place. Now if we use the relevant words, it must be concluded that that section clearly creates an illegality which seeks to redress a mischief such as the one committed in the present case. The debtor company became "bankrupt within twelve months of the transaction" and "supplied... property" to related persons in the form of creating a charge upon its property to enable it to use the proceeds of a loan secured by such a charge in order to pay a dividend to a related person to enable that person to purchase shares of the debtor company held by another related person, which company clearly formed part of the related group.

20 My conclusion therefore is that the trustee is correct in claiming that the transaction was without consideration and should be declared illegal under section 78. Since there was no consideration whatsoever, the question of fair market value obviously need not be considered.

21 Although this conclusion that Article 78 applies affirmatively to the present case disposes of the matter, one could go even farther and declare that, under the circumstances of this case, there was such gross negligence on the part of the directors of the bankrupt company that a right was created in favour of the trustee to recover from them the amount of the dividend so declared.

22 Roland J. Willis in an article entitled, "The Action of the Trustee Against the Directors of a Trust Company on the Ground of Negligence", 8 C.B.R. page 109, refers to the following decisions : Overend & Gurney v. Gibb (1872) LR 5 H.L. 480 at p. 486 :

> "Whether or not the directors exceeded the powers entrusted to them or whether if they did not so exceed their powers they were cognisant of circumstances of

> such a character, so plain, so manifest, and so simple of appreciation, that no men with any ordinary degree of prudence, acting on their own behalf, would have entered into such a transaction as they entered into?"

23 In Hart v. Felsen (1924) 30 R.L. N.S. 109, a trustee of the estate of a company brought an action against two directors of the company. The company had advanced funds to the two directors to enable them to purchase the shares of a deceased director. The Quebec Superior Court held the two directors liable in their capacity as directors for the misappropriation of funds of the company. Incidentally, the presiding judge in that case was Thibodeau Rinfret J. who later became the Chief Justice of the Superior Court of Canada.

24 Commenting on the Supreme Court of Canada's decision in Eisenberg (formerly Walton) v. Bank of Nova Scotia and Ridout [1965] S.C.R. 681, 7 C.B.R. (N.S.) 264 the author of that article writes as follows :

> "The writer submits that, on the facts of the RIDOUT case, the trustee could have brought an action against the president, in his capacity of director, on the ground of negligence. The act of pledging the assets of a company as security for a personal loan is the clearest form of "gross negligence".
>
> A possible alternative ground of an action by the trustee against the president would be breach of a director's fiduciary duties of loyalty and good faith."

25 The Courts have held that there is a stigma of illegality attaching to a security given by a company in connection with the purchase of its shares. This dictum must be doubly true when none of the parties involved were acting at arm's length.

26 This too is a case where it is appropriate, in my opinion, to exercise my judicial discretion in favour of the mass of creditors who have been deprived of the amount of this dividend which would otherwise have formed part of the patrimoine of the estate and thus would have been an asset which would have assisted in the reduction of their lawful claims against the bankrupt company.

27 For, if section 153 of the Bankruptcy Act means what it says, this Court, that is, the Superior Court of this Province, is invested with such jurisdiction in equity as will enable it to exercise original, auxiliary and ancillary jurisdiction in bankruptcy. In the exercise of such jurisdiction in equity, I consider that I am entitled to apply the following principle in condemning the respondents in this case to reimburse the trustee...

> "It is an inflexible rule of a Court of Equity that a person in a fiduciary position... is not, unless otherwise expressly provided, entitled to make a profit; he is not allowed to put himself in a position where his interest and duty conflict."

(Finn, Fiduciary Obligations (1977) Law Book Co. para 464 p. 200, quoted by Professor Anthony Sheppard in Recent Developments in the Law of Bankruptcy-Insolvency Bulletin issued by the Office of the Superintendent of Bankruptcy-Canada, February 1983, Vol. 3, No. 2.)

28 It will have been noted from the above that I have not felt it necessary to decide whether the bankrupt company was insolvent at the particular time of this impugned transaction, nor whether the said payment of the dividend rendered it insolvent - (Section 79). But, relevant or not, I find, on the question of fact, that all of the parties personal and corporate, at such times were "related persons" and formed part of "related groups". Thus the onus lies upon these directors and shareholders to prove the company's solvency at such times. (Section 79(5)).

29 But, as I say, in view of the satisfactory proof made by the trustee under the alternative prayer in the conclusions of its motion, it is not necessary for me to make such a determination as to the then solvency of the now bankrupt company.

30 PAR CES MOTIFS, LE TRIBUNAL :

ACCUEILLE la requête du syndic en lui donnant droit à ses conclusions alternatives;

DÉCLARE nul, illégal, sans droit et fait sans considération le paiement de 355 000,00 $ à Les Entreprises Paré Inc.;

CONDAMNE conjointement et solidairement les intimés à rembourser cette somme de 355 000,00 $ avec les intérêts y afférent au taux légal depuis l'institution de la requête et avec les dépens.

BRENDAN O'CONNOR, J.C.S.

qp/s/qw/qlnep/qlana

TAB 7

Case Name:

Indcondo Building Corp. v. Sloan

Between
Indcondo Building Corporation, Plaintiff, and
Valerie Frances Sloan, David Robin Sloan and Cave Hill
Properties Ltd., Defendants

[2014] O.J. No. 3722

2014 ONSC 4018

121 O.R. (3d) 160

243 A.C.W.S. (3d) 873

121 O.R. (3d) 160

16 C.B.R. (6th) 220

2014 CarswellOnt 10946

Court File No. CV-08-7587-00CL

Ontario Superior Court of Justice

M.A. Penny J.

Heard: May 26-30, June 2 and 3, 2014.
Judgment: July 31, 2014.

(168 paras.)

Civil litigation -- Civil procedure -- Estoppel -- Estoppel in pais (by conduct) -- Laches or delay -- Action by Indcondo Building Corporation to set aside four property transfers allowed in part -- After obtaining judgment against the defendant Sloan for breach of contract, Indcondo became aware of transfers of property by Sloan to a corporation owned and controlled by his wife -- The defendants submitted that the action should be dismissed on the basis of laches -- While there was inordinate delay, the prejudice relied on by the defendants lacked sufficient specificity to dismiss the

action -- Two of the four property transfers were undertaken with the intent to defeat creditors and had to be set aside -- Fraudulent Conveyances Act, s. 2.

Creditors and debtors law -- Fraudulent conveyances -- Conveyances that are void -- Intent to defeat, hinder, delay or defraud creditors -- Action by Indcondo Building Corporation to set aside four property transfers allowed in part -- After obtaining judgment against the defendant Sloan for breach of contract, Indcondo became aware of transfers of property by Sloan to a corporation owned and controlled by his wife -- The defendants submitted that the action should be dismissed on the basis of laches -- While there was inordinate delay, the prejudice relied on by the defendants lacked sufficient specificity to dismiss the action -- Two of the four property transfers were undertaken with the intent to defeat creditors and had to be set aside -- Fraudulent Conveyances Act, s. 2.

Action by Indcondo Building Corporation to set aside four transfers of property. In 1992, Indcondo obtained judgment against the defendant Sloan for damages for breach of contract. In the course of seeking to enforce its judgment, Indcondo discovered that Sloan had transferred half his interest in the matrimonial home to his wife after he was served with Indcondo's statement of claim. Indcondo commenced a fraudulent conveyance action which was stayed as a result of Sloan's bankruptcy. However, during the course of the fraudulent conveyance action, Indcondo became aware of other alleged transfers of property by Sloan to a corporation owned and controlled by his wife. Indcondo took the position that the property transfers were undertaken with the intent to defeat, hinder, delay, or defraud creditors. The defendants took the position that Indcondo's action should be dismissed on the basis of laches as there had been inordinate delay and prejudice resulting from that delay.

HELD: Action allowed in part. While Indcondo had been guilty of inordinate delay, the prejudice relied on by the defendants lacked sufficient specificity. Therefore, the action was not dismissed on the basis of laches. With respect to two of the four property transfers, the Court was unable to conclude on the evidence that they were undertaken with the intent to defeat creditors. However, the other two property transfers were undertaken with the intent to defeat Sloan's creditors and therefore had to be set aside.

Statutes, Regulations and Rules Cited:

Bankruptcy and Insolvency Act, R.S.C. 1985, c. B-3, s. 38

Fraudulent Conveyances Act, R.S.O. 1990, c. F.29, s. 2, s. 3

Counsel:

Trung Nguyen and P. James Zibarras, for the Plaintiff.

Philip P. Healey, for the Defendants.

M.A. PENNY J.:--

Overview

1 This is an action to set aside certain transfers of property on the basis that they were undertaken with the intent to defeat, hinder, delay or defraud creditors. The litigation began in 1992 with Indcondo's claim for damages for breach of a contract to purchase its shares in a real estate development company. John Di Paola is the sole shareholder of Indcondo. A judgment was obtained by the plaintiff at an undefended trial against the defendant, Robin Sloan, in 2001. A fraudulent preference action was commenced by the plaintiff in 2002 seeking to set aside the 1992 transfer of Sloan's half interest in his matrimonial home to his wife, Valerie Sloan. In the course of that action, the plaintiff became aware of other transfers of property from Sloan dating back to 1987 and 1988.

2 Sloan declared bankruptcy in 2004 and the plaintiff's fraudulent conveyance action was stayed. The plaintiff filed a proof of claim in Sloan's bankruptcy. Sloan received an absolute discharge in 2005. In April 2006, the plaintiff obtained an *ex parte* order under s. 38 of *The Bankruptcy and Insolvency Act* authorizing it to proceed in its own name with an action to set aside the impugned transfers of property. This action was not commenced until June 2008.

3 The action was dismissed by order of Morawetz J. on a limitations issue. The Court of Appeal reversed Morawetz J.'s order. The action was again dismissed as an abuse of process, on grounds of issue estoppel, by Mesbur J. That order too was reversed by the Court of Appeal. The matter was case managed to trial by D. Brown J. Thus, after 23 years of litigation, a seven-day trial was finally conducted in this matter from May 26 to June 3, 2014.

4 There are four transfers of property by Sloan which are challenged:

(1) transactions involving the 1987 transfer of property referred to as the "Bowes property" to Cave Hill Properties Limited, a company owned by Valerie;
(2) transactions involving the transfer of the "Hill 'N' Dale" farm property to Cave Hill in1987 and 1988;
(3) transactions involving the transfer of the matrimonial home, 42 Riverside Boulevard to Valerie in 1992; and
(4) a transaction involving the transfer of a Florida condominium to Valerie in 1993.

5 The plaintiff also seeks to pierce the corporate veil in connection with assets owned by Cave Hill. These assets include the properties listed above (apart from 42 Riverside), or proceeds from

the sale of these properties, as well as other assets alleged to have originated with Sloan but later been transferred to Cave Hill.

6 Valerie suffered a serious stroke in 1996 and lives in a long-term care facility. Her affairs are managed by Sloan, who holds her power of attorney, and a long-time friend and former colleague of Sloan's, Bruce Pender. Valerie gave brief evidence by affidavit but was not cross-examined at trial.

7 Before turning to the specific transactions in issue, it is necessary to set out, in some detail, the background and circumstances giving rise to these transactions and the litigation.

Background

8 In 1967, Sloan started a business with Frank Stronach called Unimade Industries Limited. In 1974, Unimade was acquired by Magna for Magna shares and Sloan went to work for Magna.

9 From 1974 to 1986, Sloan was a vice president at Magna. During part of this time, he headed up MI Developments, Magna's real estate acquisition arm. While doing so, he came to know Bruce Pender, an accountant who was a fellow Magna employee, and Doug Ford, an in-house lawyer employed by Magna.

10 In 1985, Sloan, Di Paola and several other businessmen formed a private real estate development company called Steeles-Jane Properties Inc. It is common ground that this was a period when the Toronto real estate market was booming. The company was set up as a vehicle to buy property, develop it, and either resell at a profit or lease and refinance, using the proceeds to invest in additional properties.

11 The principals, who were all involved in construction or real estate development in some way, each invested in Steeles-Jane through holding companies. The plaintiff is Di Paola's company. Sloan's company was called Ascania Investments Inc.

12 The shareholders and interests in Steeles-Jane were as follows:

Shareholder	Principal	Number of Shares	%	Date of Share Issuance
Indcondo	John Di Paola	100	10%	June 17, 1985
Rocar Construction Limited	Carlo Rotundo	200	20%	June 17, 1985
Lostrock Corporation	Anton Czapka	200	20%	June 17, 1985
CIFU Safe Investments Limited	Carmen Alfano	150	15%	June 17, 1985
Conleo Holdings Limited	Leo Rinomato	150	15%	June 17, 1985
623742 Ontario Inc. / Ascania Investments Inc.	David Robin Sloan	200	20%	June 17, 1985

13 Carlo Rotundo acted as President and was the most active of the principals in the operations and affairs of the company. Unlike the other shareholders, Di Poala/Indcondo did not invest any money in Steeles-Jane. Di Poala "earned" his shares by providing real estate agent services without commission.

14 The parties entered into a shareholders' agreement in 1985. That agreement restricted the sale of shares by the shareholders. As between shareholders, the shareholders agreement contained a buy/sell, or "shotgun," clause which permitted any shareholder to make an offer to acquire another shareholder's shares. The offeree had the option to accept that offer or acquire the offeror's shares at the offered price.

15 Paragraph 4.03 of the shareholders' agreement dealt with purported transfers of shares to persons who were not existing shareholders. In that case, any purported transfer was deemed to be a grant by the shareholder involved of an option to Steeles-Jane to purchase the shares at a value of 80% of the original purchase price.

16 The shareholders agreement was amended in 1987 to provide that paragraph 4.03 would not apply to any transfer by any of the parties to the agreement if the "purported sale occurred within a period of 90 days after the fifth anniversary date of this agreement and/or every fifth anniversary thereafter." Thus, by June 1990, any Steeles-Jane shareholder had a 90 day window during which it

would be entitled to sell its shares to a third-party without penalty under paragraph 4.03.

17 The financial statements of Steeles-Jane show that by the year ended May 31, 1988, Steeles-Jane had accumulated total assets of $35 million (based on acquisition and carrying costs). Steeles-Jane also had liabilities of $34 million, largely from mortgages and bank indebtedness. Retained earnings for that year were a little over $700,000.

18 The Steeles-Jane financial statements show that by the year ended, May 31, 1989, the total assets of Steeles-Jane (again based on acquisition and carrying costs) had grown to over $70 million and liabilities, again largely in the form of mortgages and banking indebtedness, had grown to over $66 million, producing retained earnings of some $3.8 million in that year.

19 It is not contested that the principals of the shareholders were required to give the bank and mortgage lenders personal guarantees as security for the financing of Steeles-Jane's acquisitions and operations.

20 Di Paola's evidence was that from 1987 on he raised with the other principals including Sloan concerns about the direction Steeles-Jane was taking. He was concerned, he said, about the highly leveraged nature of the Steeles-Jane balance sheet and that, if the market turned, they would lose everything. Di Paola said that by the fall of 1988, he advised the other principals that he wanted out and would be exercising his right to sell on the first five-year anniversary.

21 There is little objective support for Di Paola's evidence that he was sounding the alarm as early as 1987. First, Di Paola produced no documentary evidence reflecting or demonstrating his concerns. There is no evidence that he had any discussions with any of the other shareholders about using the buy/sell provisions to buy him out. He called no corroborative evidence from other principals or witnesses. There is no evidence that in 1987 the real estate market was entering a downturn. Sloan does not support the contention that Di Paola raised concerns about the viability of Steeles-Jane at this stage.

22 Apart from the fact that the shareholders' agreement was amended to permit the sale (without penalty) of shares on the fifth anniversary of the formation of Steeles-Jane, there is no evidence of financial concerns being expressed about Steeles-Jane in 1987 or 1988, apart from Di Paola's uncorroborated evidence, which I find is tainted by both his self-interest in placing the date that concerns about Steeles-Jane's financial viability were raised as early as possible and the enormous passage of time since the relevant events.

23 I do, however, accept that by September 1989, the five-year anniversary was on the horizon. The minutes of the shareholders' meeting from that month reflect the fact that Rotundo reminded the shareholders that the corporation's fifth year anniversary would be on May 30, 1990, that any of the shareholders had the right to dispose of their shares without penalty at that time and that, if any shareholder intended to exercise this right, he should make his intentions known so as to provide ample time to perform any necessary valuations. I find that, in or around this period, Di Poala

voiced his desire to sell Indcondo's Steeles-Jane shares. Sloan agreed on discovery that, in the period leading up to Di Paola's notice of his desire to sell, he and Di Paolo had "many discussions" about it.

24 A reporting package to shareholders of October 25, 1989 shows established equity in Steeles-Jane at that time of almost $48 million. No evidence was presented about the basis or background of the calculations shown in this shareholder package. The significant difference from the May 1989 financial statements appears to derive from the use of market values for the properties owned rather than their acquisition cost.

25 The evidence discloses that by April 23, 1990, Di Paola had negotiate a "put/call" agreement providing for the potential buyout of all of Indcondo's Steeles-Jane shares over time at a price of $50,000 per share (Indcondo held, following a stock split, 100 shares such that the purchase price, if Indcondo chose to exercise all of its put rights, was $5 million). Based on the schedule agreed to, if Di Paola exercised all of Indcondo's puts under the agreement, the last tranche would be acquired by October 1994.

26 The put/call agreement was between Indconco and Steeles-Jane. It provided, however, in paragraph 3.03, that if Steeles-Jane defaulted by failing to purchase any of its shares from Indcondo when required to do so, the principals of the other shareholders, including Sloan, "shall be jointly and severally obligated to purchase such shares from Indcondo for the [agreed] option price per share" on the closing dates specified in the agreement.

27 At the end of April 1990, Steeles-Jane's rights to purchase the first tranche of Indcondo's Steeles-Jane shares were assigned to CIFU (Alfano) and Conleo (Rimomato). In this way, Alfano and Rinomato would each increase their shareholdings in Steeles-Jane by 5%, such that the remaining five shareholders would each hold 20%.

28 In October 1990, Indcondo gave notice to Steeles-Jane of its intention to exercise its option to sell 10 more shares under the schedule of put options. These shares were also purchased by CIFU and Conleo in November 1990 and January 1991.

29 In March 1991, CIFU (Alfano) and Conleo (Rinomato) provided indemnities to Sloan (and, according to Sloan, the other remaining shareholders), in which they indemnified Sloan against any claims as a result of CIFU and Conleo's agreement to purchase Indcondo's Steeles-Jane shares.

30 In April 1991, Indcondo again gave notice to Steeles-Jane of its intention to exercise its put option to sell 10 more of its shares. CIFU and Conleo failed to purchase Indcondo's shares.

31 According to Di Paola, the reason Steeles-Jane was unable to purchase the shares was that the Toronto property market bubble had burst and that prices had started to drop. The failure of CIFU and Conleo, or Steeles-Jane, to acquire the April, 1991 tranche of Indcondo's shares gave rise to negotiated amendments to the put/call agreement.

32 The First Amendment, dated May 28, 1991, provided that Steeles-Jane or its assignees would acquire one of Indcondo's Steeles-Jane shares per month, commencing May 15, 1991, for the following 10 months. The agreement reiterated that if Steeles-Jane or its assignees failed to close any of the transactions in the First Amendment, that failure would be subject to the joint and several liability of the other principals under paragraph 3.03 of the put/call agreement. The first five shares were purchased from Indcondo by CIFU and Conleo in accordance with the First Amendment. However, on October 15, 1991, Steeles-Jane breached the First Amendment when CIFU and/or Conleo failed to purchase the share designated for purchase on that date.

33 Further, on October 16, 1991, Indcondo gave a third notice to Steeles-Jane of its intention to exercise its put option under the put/call agreement for the sale of the next tranche of its Steeles-Jane shares. Steeles-Jane/CIFU/Conleo failed to purchase Indcondo's 10 shares by the end of October 1991 in breach of the put/call agreement.

34 As result, the parties discussed a second amended agreement. The Second Amendment provided that:

(a) the five shares that were the subject of the First Amendment would be purchased on certain specified dates;
(b) the 10 shares that were the subject of Indcondo's October 1991 notice would be purchased on March 14, 1992; and
(c) if Steeles-Jane, Conleo or CIFU failed to purchase the shares on the prescribed dates, the principals would be required to do so in accordance with paragraph 3.03 of the put/call agreement.

Although the Second Amendment was never signed, it appears that three of the five shares outstanding were purchased in October, November and December 1991 but that, in January 1992, Conleo and CIFU failed to purchase the common share designated for that date, in breach of the Second Amendment, and failed to purchase any additional shares, in further breach of the put/call agreement and the Second Amendment.

35 Di Paola gave evidence that there were further verbal agreements, tied to pending sales of specific properties, under which Indcondo agreed to forbear from enforcement of its rights in exchange for the promise of payment once the pending property sales closed. These agreements were not fulfilled and so, in March 1992, Indcondo finally gave notice to the principals that it required the principals to purchase Indcondo's shares under paragraph 3.03. At that point, the principals were jointly and severally liable to purchase from Indcondo its remaining 69.5 common shares at a price of $65,847 (the amounts included accumulated interest) per share for a total amount owing of $4,576,366.50.

36 The principals failed to acquire Indcondo's shares in accordance with paragraph 3.03 of the put/call agreement. Accordingly, on May 21 1992, Indcondo issued a statement of claim against Steeles-Jane and the principals to recover the $4,476,366.50 of indebtedness.

37 From 1992 to 1996, Di Paola says he was unable to afford counsel and the action languished. In August 1996, however, he was able to retain counsel and the action continued. In September 2001, Indcondo obtained a trial date to commence in December 2001. On the eve of trial, Sloan's lawyer advised that he would not be attending as he had not been retained for the trial. The trial proceeded on an undefended basis against Sloan. Molloy J. granted judgment in the amount of $8,010,575.30 plus interest at 15% (apparently based on the interest rate payable on amounts due and owing to Indcondo under the put/call agreement).

38 That judgment has never been set aside or appealed from.

39 In the course of seeking to enforce its judgment, Indcondo discovered that Sloan had transferred his half interest in the matrimonial home, 42 Riverside, to Valerie after he had been served with Indcondo's statement of claim. Indcondo commenced an action in August 2002 to set aside the conveyance of Sloan's 50% interest in 42 Riverside as being contrary to the *Fraudulent Conveyances Act*. Apparently, sometime during the course of that proceeding, Indcondo became aware of other alleged transfers of property by Sloan to a corporation owned and controlled by Valerie.

40 What happened next was comprehensively summarized by Mesbur J. in her Endorsement on a motion to dismiss this action, dated August 30, 2011. I cannot do better than simply repeat her words:

> [4] In January 2004, Mr. Sloan declared personal bankruptcy. As a result of the bankruptcy the First Fraudulent Conveyances Action was stayed. Mr. Sloan listed only two creditors: Indcondo in the amount of $8.7 million and the Royal Bank of Canada for about $12 million. Indcondo proved its claim in the bankruptcy. Its principal, Mr. DiPaola, was active in the bankruptcy proceedings, and urged the Trustee to follow up on trying to get the matrimonial home and other properties back into the estate.
>
> [5] Mr. DiPaola requested a meeting of creditors, which was held on March 26, 2004. At the meeting, Mr. DiPaola questioned the bankrupt regarding a number of financial issues, and asked the Trustee what he would be doing about pursuing some of the transactions. Many of the transactions related to events that occurred in the years 1993 to 1996. The Trustee advised that the items raised were "outside the timeframes for challenging transactions pursuant to the *Bankruptcy and Insolvency Act*. More importantly, any action to be pursued by the estate would have to be funded by the creditors as the estate is impecunious."
>
> [6] Mr. DiPaola then advised the meeting he would be requesting an examination of the bankrupt pursuant to Section 161 of the *Bankruptcy and Insolvency Act*.

The minutes of the meeting record that Mr. DiPaola was made aware of his rights under section 38 of the *Bankruptcy and Insolvency Act* to pursue any action not taken up by the estate.

[7] Mr. DiPaola's next action was to write to the office of the Superintendent of bankruptcy, seeking the OSB's cooperation in investigating this file. Although Mr. DiPaola knew of Indcondo's rights under section 38 in March of 2004, he did not take any steps at that time to obtain a section 38 order. He waited until 2006 to do so, and then waited another two years before actually commencing the section 38 Fraudulent Conveyances action itself.

[8] Because Mr. Sloan was a first time bankrupt, he came up for discharge in 2005. The Royal Bank of Canada did not oppose the discharge, but Mr. DiPaola did so on Indcondo's behalf. His notice of intended opposition set out alleged offences under Section 173 of the *Bankruptcy and Insolvency Act*, as well as section 195. The notice goes on to say "The creditor wishes to conduct Section 163 examinations of the following after it had received Section 161, Official Receiver's Report on September 24, 2004."

[9] Mr. Sloan's initial discharge hearing was set for April 5, 2005. Indcondo sought an adjournment in order to examine the bankrupt. Although the discharge hearing was adjourned for that purpose, Indcondo's counsel never conducted an examination. I have no evidence as to why not. The Trustee's report on Mr. Sloan's application for discharge showed nothing improper in the bankrupt's conduct. The Trustee did not oppose the bankrupt's discharge, but noted that a creditor had opposed the discharge. Mr. DiPaola's opposition on Indcondo's behalf was attached to the Trustee's report.

[10] Mr. DiPaola then wrote to the Trustee, and attached to his letter a resolution of the inspector (namely Mr. DiPaola) disapproving the Trustee's report.

[11] The discharge hearing was rescheduled for August 19, 2005. Counsel for the bankrupt sent a letter to Indcondo's counsel by fax and mail a month before the new date. In the letter, she advised Indcondo's counsel of the date and time for the new discharge hearing. Indcondo did not attend, nor did any other opposing creditor. The Registrar granted an absolute discharge. The discharge order recites that no one appeared for the opposing creditor, Indcondo, although properly

served. It goes on to recite that "No proof has been made of any facts under Section 173 of the *Bankruptcy and Insolvency Act*."

[12] Mr. Sloan's lawyer then send a copy of the discharge order to Indcondo's lawyer, Mr. Chapman. In the letter, he says:

> As a result of the discharge order, the action [i.e. the First Fraudulent Conveyances Action] should be dismissed. My proposal is that it be dismissed on a without costs basis... If I do not hear from you by the above noted diary date [October 3, 2005] I will presume that you will not consent and proceed to bring a motion... If I am forced to bring such a motion, I will be seeking costs of the action.

[13] Mr. Chapman did not respond. On October 17, 2005 Mr. Sloan's lawyer wrote to him again, and asked for the courtesy of a reply. He suggested Mr. Chapman simply obtain ups instructions to consent.

[14] About 10 days later Mr. Chapman responded, saying "I have asked my client for instructions." He did not, however, ever advise whether he received any instructions, or what those instructions were. As a result, Mr. Sloan's counsel proceeded to schedule a motion to dismiss the First Fraudulent Conveyances Action. Mr. Sloan's lawyer wrote to Mr. Chapman on January 5, 2006 to advise him that since Mr. Chapman had not responded regarding his client's position, a motion to dismiss was scheduled for April 5, 2006.Mr. Chapman was served with the motion materials, but did not appear on the motion, and did not deliver any responding materials to it.

[15] On April 5, 2006 Belobaba J made the requested order. Indcondo did not attend that motion, but the following day counsel for Indcondo attended *ex parte* before the Registrar and obtained an order under Section 38 of the *Bankruptcy and Insolvency Act* to take proceedings to set aside certain reviewable transactions by the bankrupt. Having shown it was a creditor, had requested the Trustee to act in terms of setting aside fraudulent conveyances, and the Trustee having refused to do so, the court made the order. Although Indcondo obtained the s. 38 order in 2006, it did not begin its action pursuant to the order until 2008. These new proceedings became the Section 38 Fraudulent Conveyances Action, namely, this action.

> [16] Some nine months after Belobaba J had dismissed the First Fraudulent Conveyances Action, Indcondo suggested its failure to attend the motion before Belobaba J was due to inadvertence. It sought to set aside the dismissal order on that basis. The motion came on before Low J on October 20, 2006. She dismissed the motion with costs against Indcondo of $2,500. She found first, there was no inadvertence; Indcondo simply failed to provide its counsel with instructions. Second, Low J held Indcondo had failed to explain its delay in moving to set the order side.
>
> [17] Once Low J made her order, the First Fraudulent Conveyances Action was definitively dismissed. Indcondo did not appeal Low J's order.
>
> [18] Even though it obtained the Section 38 order, Indcondo waited two years to commence the Section 38 Fraudulent Conveyances Action. In it, it makes identical claims as it had in the First Fraudulent Conveyances Action against the bankrupt, his wife and Cave Hill, the successor to the numbered company which had been the corporate defendant in the First Fraudulent Conveyances Action.

41 As noted above, motions to dismiss this action on limitations grounds, initially granted by Morawetz J., and as an abuse of process, initially granted by Mesbur J., were overturned by the Court of Appeal for Ontario.

42 With that background to set the context, I will now turn to the major issues in dispute.

The Impugned Transactions

1. The Law of Fraudulent Conveyances

43 The *Fraudulent Conveyances Act,* R.S.O. 1990, c. F-29, provides, in s. 2:

> Every conveyance of real property or personal property and every bond, suit, judgment and execution heretofore or hereafter made with intent to defeat, hinder, delay or defraud creditors or others of their just and lawful actions, suits, debts, accounts, damages, penalties or forfeitures are void as against such other persons and their assigns.

44 Thus, in order for this section to apply so as to void a transaction, there must be:

(a) a "conveyance" of property;
(b) an "intent" to defeat; and

(c) a "creditor or other" towards whom that intent is directed,

> see *Bank of Nova Scotia v. Holland*, [1979] O.J. 1190 at para. 12.

45 The courts have interpreted the words "or others" broadly to include potential beneficiaries under a guarantee (where demand has not been made) and subsequent creditors. Indeed, courts have found that, in some circumstances, it is not necessary for there to be any creditors at all at the time of a transaction in order to conclude that it was done with the intent to defeat creditors.

46 Galligan J. held in *Bank of Nova Scotia, supra,* that, although the holder of a guarantee upon which no demand has been made may not be a "creditor," the beneficiary of a guarantee is an "other" within the meaning of s. 2 and entitled to the protection of the *Act*. He cited May's *Laws of Fraudulent and Voluntary Conveyances*, 3rd ed. at p.2:

> The words "creditors and others" are wide enough to include any person who has a legal or equitable right or claim against the grantor or settler by virtue of which he is, or may become, entitled to rank as a creditor of the latter.

47 Is also not necessary for a party, in attempting to impeach a conveyance, to demonstrate that it had an actual debt owing to it at the time of the conveyance. In *Benyon v. Beynon*, [2001] O.J. 3653, the court noted that "creditors and others" is broad enough to contemplate a person who, while not a creditor at the time of the conveyance, may become one in the future.

48 If there was an intention to defeat creditors, then it does not matter whether it was to defeat present or future creditors, see *CIBC v. Boukalis* 1987 CarswellBC 513 (B.C.C.A.). If an intent to defraud existed at the time of the conveyance, it does not matter that the person attacking it was not a creditor at the time, *Iamgold v. Rosenfeld*, [1998] O.J. 4690 (S.C.J.).

49 The *Fraudulent Conveyances Act* was enacted to prevent fraud. It is remedial legislation and must be given as broad an interpretation as its language will reasonably bear. The purpose of the *Act* was expressed by Prof. Dunlop in *Creditor-Debtor Law in Canada*, 2nd ed. at p. 598:

> The purpose of the Statute of Elizabeth and of the Canadian Acts based on it, as interpreted by the courts, is to strike down all conveyances of property made with the intention of delaying, hindering, or defrauding creditors and others except for conveyances made for good consideration and bona fide to persons not having notice of such fraud. The legislation is couched in very general terms and should be interpreted liberally.

50 Prof. Dunlop also considered the judicial difficulties in establishing fraud by ascertaining the state of mind of the debtor; that is, the dominant motive for effecting the impugned transaction. In the absence of direct evidence of intent, he said, "courts have been ready to rely on the surrounding

circumstances as establishing *prima facie* the intent to defraud or delay... the so-called badges of fraud being nothing more than typical and suspicious fact situations which may be enough to enable the court to make a finding."

51 In most cases, a finding concerning the necessary intention to defeat creditors cannot be made except by drawing an inference from the circumstances. If existing creditors are well secured, it may be that one is unlikely to infer that the conveyance was made in order to defeat them. Of course, the time for considering intent is the time of the conveyance, *CIBC V Boukalis, supra*, at p. 4.

52 The badges of fraud derive from *Twyne's Case* (1601) 76 E.R. 809. As interpreted by modern courts, the badges of fraud include:

(d) the donor continued in possession and continued to use the property as his own;
(e) the transaction was secret;
(f) the transfer was made in the face of threatened legal proceedings;
(g) the transfer documents contained false statements as to consideration;
(h) the consideration is grossly inadequate;
(i) there is unusual haste in making the transfer;
(j) some benefit is retained under the settlement by the settlor;
(k) embarking on a hazardous venture; and
(l) a close relationship exists between parties to the conveyance.

53 The badges of fraud represent evidentiary rules developed over time which, when considered in all the circumstances, may enable the court to make a finding unless the proponents of the transaction can explain away the suspicious circumstances. Is clear that the legal or persuasive burden to prove the case remains on the plaintiff throughout the trial. Nevertheless, the plaintiff may raise an inference of fraud sufficient to shift the *evidentiary* burden to the defendant if the plaintiff can establish that the transaction has characteristics which are typically associated with fraudulent intent. Proof of one or more of the badges of fraud will not compel a finding for the plaintiff but it may raise a *prima facie* evidentiary case which it would be prudent for the defendant to rebut.

54 The leading articulation of this burden was set out in *Koop v. Smith* (1915), 51 S.C.R. 554, where Duff J. held:

> I think the true rule is that suspicious circumstances coupled with [a close] relationship make a case of *res ipsa loquitor* which the tribunal of fact may and will generally treat as a sufficient *prima facie* case, but that it is not strictly in law bound to do so; and that the question of the necessity of corroboration is strictly a question of fact.

55 Kruzick J. put the matter succinctly when he said, in *Beynon, supra,* at paras. 49 and 52:

> I am mindful of the fact that I must be very careful to avoid using the badges of fraud doctrine mechanically... fraudulent assignment depends not so much on the tally of "badges" but upon the view of all the facts...

> Although the primary burden of proving the case remains with the plaintiff, the existence of one or more of the traditional "badges of fraud" may give rise to an inference of intent to defraud in the absence of an explanation from the defendant. In such circumstances, there is an [evidentiary] onus on the defence to adduce evidence showing an absence of fraudulent intent.

56 The transfer of property to a person in a close relationship is, of course, itself a badge of fraud. In such cases the testimony of the parties as to their subjective intent must be scrutinized with care and suspicion; it is very seldom that such evidence can be safely acted upon as in itself sufficient. In cases involving a transfer to near relatives, as matter of prudence the court should most often require corroborative evidence of the bona fides of the transaction.

57 At the end of the day, however, the court must act on such a preponderance of evidence as to show whether the conclusion the plaintiff seeks to establish is substantially the most probable of the possible views of the facts; mere suspicion is not sufficient, *Clarke v. The King* (1921), 61 S.C.R. 608 at 616.

58 This raises the question of the standard of proof in fraudulent conveyance actions. Different submissions were made on this issue at the close of trial. The plaintiff says the standard of proof in a fraudulent conveyances action is, like any civil action, on a balance of probabilities. The defendants argue that a higher standard must be met in quasi-criminal cases where allegations of serious misconduct, like fraud, are alleged.

59 The Supreme Court of Canada in *C. (R.) v. McDougall*, [2008] 3 S.C.R. 41 put this issue to rest. That case involved a civil action for damages for sexual assault. Although some cases involve more serious consequences by the nature of the allegations made in them, the seriousness of the allegations does not alter the standard of proof in civil cases. The majority held that there is only one standard of proof in all civil cases and that standard is 'proof on a balance of probabilities.'

60 Finally, I should comment on the expert evidence. Both parties filed expert reports from accountants on the transactions in issue and the flow of funds associated with those transactions. Both sides objected to the other expert's evidence, essentially on the grounds that their opinions exceeded their area of expertise and extended into purporting to answer the very question for the court in this case - were these transactions done with fraudulent intent?

61 I allowed the testimony of both experts into evidence, indicating that the objections could be revisited in argument and would go to weight. Both were cross-examined on their reports. In the end, little reference was made to the testimony of the experts in argument.

62 I found the factual presentation and organization of both experts helpful but I also found they both were, in effect, trying to answer the very question that must be addressed by the court in this case. As such, in the end, while I found the methodology helpful in parsing the transactions, I gave their conclusions little if any weight.

2. The Formation of Cave Hill Properties Limited

63 The evidence is somewhat vague on this issue but sometime in 1987, Sloan decided to cash in his Magna shares (issued at the time of the acquisition by Magna of Unimade), reacquire Unimade from Magna and leave his employment at Magna to run Unimade.

64 Sloan used the proceeds of the sale of his Magna shares, and other funds he had accumulated to that point, to purchase Unimade and to acquire the Hill 'N' Dale property. The manner in which these transactions were structured is controversial. I will begin by explaining how Cave Hill Properties Limited came to be.

65 Sloan incorporated 723938 Ontario Limited (938) in June, 1987. In December 1987, Sloan transferred his shares in 938 to Valerie Sloan and executed a declaration of trust in respect of those shares. Thus, from December 1987 forward, Valerie was the sole shareholder of 938.

66 When Unimade was set up in 1966, it acquired property in Vaughan from which Unimade's business (the supply of structural steel) was run. This was known as the Bowes property. In 1974, Unimade, including the Bowes property, was acquired by Magna. In 1987, 938 acquired the Bowes property from Magna for about $1.4 million. A vendor takeback mortgage was granted by Magna to 938 for the full amount. The mortgage payments were made by 938 from the proceeds of rents charge to tenants of the Bowes property.

67 938 leased the Bowes property to Unimade at market rates until Unimade ceased operations following the recession in 1991/1992. After that, 938 leased the Bowes property to a third-party and eventually sold it, in 1999, to another third-party for $2.5 million.

68 In the course of these activities, 938 changed its name to Cave Hill Properties Limited and later, in 1996, amalgamated with other companies owned by Valerie to form the current Cave Hill entity.

69 David Ford was called to the Bar in 1981 and practised corporate commercial, real estate and tax law as an in-house lawyer with Magna throughout the 1980s. While at Magna, he worked closely with Sloan, Bruce Pender and other senior officers of Magna.

70 Ford started providing tax consulting and estate planning advice to Sloan, Valerie and Mr. Pender in the early 1980s. He testified that in about 1987, Sloan told him that, since he accumulated considerable assets, Sloan wanted his family to have their own "nest egg" independent of his assets. Sloan told Ford that the Hill 'N' Dale property, which was acquired in December 1987, could serve

the purpose of building that "nest egg." Ford told Sloan that he should enter into a nominee and trustee agreement to confirm that Sloan was holding title to Hill 'N' Dale as a nominee/bare trustee and that the beneficial owner should be a separate legal entity owned by Valerie so that all assets and liabilities would be contained in that entity.

71 Ford testified that in 1988, he became aware of an opportunity to reduce future potential taxable gains on the Hill 'N' Dale property by creating an immediate gain in a tax efficient manner, thereby increasing the cost base and reducing taxable gains from a future potential sale. The transaction required three clean shelf corporations which had been incorporated before Sloan became the registered owner of Hill 'N' Dale. Ford had incorporated three such shelf corporations for Magna on June 4, 1987 which, he knew, were surplus to Magna's needs. As a result, these were sold to Sloan for Magna's cost of incorporation. The companies were 721310 Ontario Inc. (310), 721311 Ontario Inc. (311) and 721312 Ontario Inc. (312). The shares of 311 were transferred to 310 and the shares of 312 were transferred to Valerie, all on the same day Sloan acquired these corporations in July 1988. The transfers were said to "have effect from" December 1987.

72 Ford's evidence was that the shares of both 310 and 312 were transferred to Valerie. Sloan's evidence, however, was that only shares of 312 were transferred to Valerie. In any event, the only documentation relating to the transfer of shares to Valerie that was produced at trial related to 312, which transfer took place on July 8, 1988.

73 Ford also gave evidence that, about the same time, Sloan entered into a nominee and trust agreement with 311 whereby Sloan remained the registered owner of Hill 'N' Dale as a nominee/bare trustee for 311. Sloan, he testified, could not have been the beneficial owner of Hill 'N' Dale, otherwise Valerie would not have been able to complete the tax transaction that ensued. No such nominee agreement, however, was available or produced at trial.

74 In essence, the 1988 tax transaction involved 311 (as beneficial owner) selling Hill 'N' Dale to 312 at its then fair market value in consideration for a note receivable, thereby creating a gain on the sale. The shares of 311 were then sold by 310 to a British Columbia numbered company which had accumulated tax losses. The net effect was that the British Columbia numbered company amalgamated with 311, thereby acquiring 311's taxable gain from the sale of Hill 'N' Dale. The British Columbia numbered company was able to offset that gain against its accumulated tax losses. These transactions were negotiated and completed for valuable consideration with an arms' length third party represented by counsel at Smith Lyons who, Ford testified, conducted thorough due diligence, including confirming that 311 held *bona fide* beneficial ownership of Hill 'N' Dale when it was sold to 312.

75 As a result of these transactions, 312 owed 310 approximately $5 million on the purchase of Hill 'N' Dale (represented by a note receivable) and 312's adjusted cost base of the Hill 'N' Dale property was now based on the 1988 purchase price at fair market value. In 1996, 310, 312 and Cave Hill amalgamated forming the "new" Cave Hill. This had the effect, among other things, of

eliminating the note receivable owing from 312 to 310.

76 Valerie has remained the sole shareholder of 312 and Cave Hill throughout. Mr. Pender is the manager of Cave Hill's assets and is paid a fee for his services in that regard. Sloan is an officer of Cave Hill but, since his bankruptcy in 2004, has not been a director. Cave Hill's assets are of considerable value and principally consist of an investment portfolio and the Hill 'N' Dale property, which has significant capital value and produces rental income. Distributions from Cave Hill, authorized by Valerie as the sole shareholder, essentially finance Valerie's care and Sloan's personal living expenses, as he has no assets of his own or other means of support.

3. The Bowes Property

77 The plaintiff attacks the transfer of the Bowes property on the following basis. Unimade was acquired from Magna with Sloan's assets. Sloan kept Unimade's shares in his name but put the Bowes property in the name of a holding company, 938, of which Sloan was the sole shareholder at the time. It was only a month later that Sloan transferred the shares of 938 to Valerie. Neither 938 nor Valerie paid any material consideration for the acquisition of the Bowes property.

78 After transferring the Bowes property to 938 and the shares of 938 to his wife, Sloan continued to treat the Bowes property as his own by causing Cave Hill to rent it to Unimade for more than $10,000 per month. When Unimade went out of business in 1992, Sloan negotiated the rental of the Bowes property to a third-party commercial tenant. In 1999, Sloan negotiated the sale of the Bowes property by Cave Hill for $2.5 million. The sale proceeds of the Bowes property were used by Cave Hill to purchase securities that form part of Cave Hill's investment portfolio. Sloan continues to derive benefit from these assets through the "largesse" of Valerie.

79 The plaintiff argues that this transfer exhibits several badges of fraud:

(a) it was made to a close relative;
(b) it was made without consideration;
(c) Sloan continue to use, or benefit from, the property post-transfer;
(d) Sloan had actual or potential liabilities on the date of the transfer; and
(e) the conveyance forms part of a pattern of conduct which resulted in essentially all of Sloan's assets being transferred to Valerie by the date of Indcondo's judgment for breach of the put/call agreement.

80 The plaintiff argues that these suspicious circumstances raise a *prima facie* evidentiary basis for an inference that the transaction was done with the intent to defeat creditors which the defendants are bound to rebut. Indcondo says the defendants have failed to do so.

81 As in so many cases involving alleged fraudulent conveyances, in this case a finding concerning the necessary intention to defeat creditors cannot be made except by drawing an inference from all of the surrounding circumstances. There is, for example, no explicit fraudulent

act in the sense of evidence that a representation was made concerning the ownership of Sloan's assets to a creditor or potential creditor which was not true. As the cases make clear, I must be careful to avoid using the badges of fraud doctrine mechanically. A finding of fraudulent intent to defeat creditors depends not on a tally of "badges" - these are but part of the factual matrix from which inferences may be drawn - but upon an assessment of all the facts bearing on the question of fraudulent intent.

82 Taken alone, the mere fact that Sloan took title to this property in a company, the shares of which he transferred to his wife for no consideration, or even that Sloan now, with the benefit of hindsight, effectively controls the resulting asset due to his wife's stroke, would not be sufficient to conclude that the transfer was made with fraudulent intent.

83 Sloan was a wealthy businessman in 1987. While at Magna, he was extremely well paid. Although the details of his profit on the sale of his Magna shares in 1987 are vague, it is nevertheless clear that he did very well indeed. As well, Sloan was about to fulfill a longtime dream of running his own business, a successful business with which he was already extremely familiar. He was also an investor in an apparently successful real estate development company along with a number of very wealthy friends and acquaintances. If he wanted to establish a nest egg for his wife and children, he was entitled to do so provided it was not with the intent of defeating creditors.

84 Sloan and Valerie's protestations that, in transferring the property to 938 and 938's shares to Valerie, there was no thought of defeating creditors is, of course, of essentially no evidentiary value. This is a case where the testimony of the parties as to their subjective intent must be scrutinized with care and suspicion. As the authorities say, it is very seldom that such evidence can be safely acted upon as in itself sufficient. As matter of prudence, therefore, I should look for corroborative evidence of the *bona fides* of the transaction.

85 The critical issue, in my view, relates to whether there were "creditors or others" toward which a fraudulent intent to defeat was directed. That there were creditors or others in 1987 is, I think, beyond doubt. The real question in analyzing the inference the plaintiff seeks to draw is whether Sloan had any reason to think that, as a result of this impugned transaction, his potential future liabilities would probably exceed his ability to pay. That requires an analysis of Sloan's assets and liabilities, or potential liabilities, at the end of 1987 in the context of what he would reasonably have believed were his prospects at the time.

86 It is necessary to comment on the fact that a good deal of documentation that one would expect to have been produced in this litigation is not available. The plaintiff asks for adverse inferences to be drawn from Sloan's failure to produce, for example, more detailed evidence of his net worth, assets and liabilities, from the 1980s and early 1990s. Sloan's response to these allegations is simple: the plaintiff's claim was not instituted until four or five years after most of the relevant dates and, given the glacial pace of this litigation since 1992, documents have gone missing or were destroyed in the ordinary course.

87 There is much to be said for the defendants' position. It is easy, with the benefit of hindsight, to say that this or that document ought to have been produced. However, the lethargy which seems to have infected the plaintiff's prosecution of its claims could easily have contributed to a false sense of security. The loss of documents is just as prejudicial to the defendants as it is to the plaintiff. While it has made everyone's job more difficult in the context of this trial, I am not willing, in the circumstances of this case, to draw any adverse inferences from Sloan's inability to produce documents which, it is to be assumed, must have existed at the relevant time.

88 While not dispositive, it is relevant that the plaintiff was not a "creditor or other" in December 1987. The put/call agreement did not even exist until April 1990. Sloan owned a successful business, Unimade. It is unknown precisely what its assets and liabilities were in 1987 (apart from the transfer of the Bowes property) but there is no suggestion that its prospects were anything but excellent. Sloan had just sold his Magna shares for a substantial profit. Sloan's investment in Steeles-Jane was doing well. While its acquisitions were almost fully financed, the real estate market was, I find, still booming in 1987.

89 The plaintiff seeks to paint a picture of looming disaster in the 1987 to 1990 period - of a real estate market, and Steeles-Jane in particular, heading for a cliff. This, in my view, is an argument entirely constructed with the benefit of hindsight. While it is true that markets have cycles, downturns, like car accidents, cannot be foreseen. It seems obvious, after the fact, what happened but at the time, it is business as usual.

90 I find that in December 1987, Sloan's existing creditors were well secured. I do not think that Sloan reasonably believed, or ought reasonably to have believed, that giving title to the Bowes property to his wife's corporation would result in his inability to make good on his existing, or contemplated, financial obligations. I am therefore unable, on this evidence, to infer that the conveyance of the Bowes property was made with the intent to defeat Sloan's "creditors or others."

4. The Hill 'N' Dale Property

91 The Hill 'N' Dale property was acquired in December 1987 for $2.17 million. It was sold in April 1989 for $7.33 million (comprised of $3.6 million cash and a $3.73 million vendor takeback mortgage). The cash and mortgage were received by 312. The purchaser eventually defaulted on the mortgage. Cave Hill took foreclosure proceedings, as a result of which Cave Hill re-acquired the Hill 'N' Dale property in November 1994 and continues to own it today.

92 The plaintiff argues that this transfer exhibits similar badges of fraud:

(a) it was made to a close relative;
(b) it was made without consideration;
(c) Sloan continue to use, or benefit from, the property post-transfer;
(d) Sloan had actual or potential liabilities on the date of the transfer;
(e) the destruction or disappearance of relevant documents concerning the

transaction; and

(f) the conveyance formed part of a pattern of conduct.

93 A great deal of time was spent at trial and in argument on the series of transactions which took place between December 1987 and the summer of 1988, all focusing on the question of whether Sloan held the Hill 'N' Dale property as bare trustee or not. As of April 1989, however, there is no question that the benefit of Hill 'N' Dale property ownership - that is, the proceeds of sale - was transferred to Cave Hill.

94 What turns on all this is whether the gift of indirect beneficial ownership in the Hill 'N' Dale property to Valerie took place in December 1987 or April 1989. This seems to be viewed by the parties as important because it either places the transfer to Valerie earlier (and therefore further in time from the eventual falling out of the Steeles-Jane shareholders and the alleged real estate market reversal) or later (and, therefore, closer to those events).

95 If, of course, the transfer of sale proceeds to Cave Hill in 1989 was not done with fraudulent intent, then what happened earlier does not matter. However, since this is a case where inferences must be drawn from the surrounding circumstances, I will address both scenarios.

96 The plaintiff argues that the whole trust argument advanced by the defendants is a sham and an afterthought. The details of the trust agreement were not, it says, even pleaded and no mention of the trust's details surfaced until shortly before trial, in the pre-filed evidence of Mr. Ford.

97 The plaintiff points to the lack of any nominee and trust agreement and to many of the "badges" described earlier - the fact that Sloan appears to have dealt with the property as if it were his own, etc.

98 The plaintiff also attacks Mr. Ford's credibility, relying on his long relationship with Sloan, the alleged "back-dating" of documents, the fact that documents surfaced from Mr. Ford's basement at the last minute and his behavior at trial generally. This is a reference to the fact that, following the completion of his testimony at trial, where the lack of documentation was repeatedly pointed out during his cross-examination, Mr. Ford searched an old precedent file in a box in his basement and located some documents relating to the 1988 tax loss transaction described above. He called Mr. Healey and was told to attend in court the next day with the documents so that Mr. Healey could review them. What transpired was a bizarre incident in which Mr. Zibarras chased Mr. Ford, and the documents, to Mr. Ford's car parked on University Avenue in front of the court. At the lunch break, I was required to make a ruling on the street when the documents were being transferred from Mr. Ford's car to the courtroom where they were to be reviewed by both parties.

99 While all of the details of the 1988 tax loss transaction were not pleaded, the essential fact, that Sloan acquired the Hill 'N' Dale property in trust for Valerie and that ownership ended up in 312, a company owned by Valeris, is pleaded. Mr. Ford is not a party and was not examined prior to trial. There is no doubt that documents one would expect to see, such as a nominee and trust

agreement executed by Sloan, have not been produced. Mr. Ford testified that there would have been such a document and that it was essential to the transaction that neither Sloan nor Valerie personally held beneficial title to the Hill 'N' Dale property. While it is true that, for tax purposes, who beneficially owned the shares of 310 and 312 was not critical, Ford's evidence was that the fundamental intent in 1987/1988 was that Valerie, through 312/Cave Hill, would have beneficial title to Hill 'N' Dale; it was a secondary purpose to reduce future tax liabilities on a sale of Hill 'N' Dale through the tax loss transaction, the result of which was to boost the adjusted cost base of the Hill 'N' Dale property in Cave Hill's hands.

100 While it is true that the two issues, whether Sloan held title in trust and the tax loss transaction, are not *necessarily* related I find, as a fact, that they *were* related in this case. In other words, the intent of the tax loss transaction was not only to achieve a desirable tax outcome regardless of who held the ultimate beneficial interest in Hill 'N' Dale but a tax benefit for 312, the shares of which were held by Valerie from the date of its acquisition.

101 The plaintiff attacks the 1988 tax transaction on essentially two levels. First, it argues that the tax transaction did not, in fact, confer title on 312. Secondly, the plaintiff argues that even if the tax transaction settled beneficial title in Hill 'N' Dale on 312, it was a sham; that is, a transparent attempt to defeat creditors.

102 I do not think the first argument can be sustained. The plaintiff's main argument on this issue rests on the fact that no nominee/bare trustee agreement has been produced and that 310 shares were not owned by Valerie at the time of the transaction. The agreement of purchase and sale and the bill of sale describe Sloan as the purchaser of Hill 'N' Dale "in trust." Registered title was taken in Sloan's name. The deed and land transfer tax affidavit do not mention any trust. However, within months of the acquisition, Sloan and Ford initiated the tax transaction, the ultimate result of which was to put beneficial ownership of Hill 'N' Dale into 312. Ford testified that there would have been a nominee and trust agreement. He said it was necessary for the deal that title be transferred to 312, not Sloan.

103 The plaintiff argues that Mr. Ford is not credible. While I agree with the plaintiff's general observation that Mr. Ford is not independent and that he shaded his evidence in an effort to help his old friend, on this point I find Mr. Ford's evidence credible. I say this for several reasons.

104 First, this was the type of deal Mr. Ford was used to doing at Magna. He had experience and expertise in this area. A nominee trust agreement was, he said, a typical and necessary feature of these types of deals. Second, and more importantly, the tax transaction involved a third-party, materially adverse in interest to Sloan and the 300-series companies. The B.C. tax loss corporation was independently represented by Smith Lyons, a law firm also experienced in these types of deals. In order for everyone to get what they bargain for, Sloan could not have been the beneficial owner of Hill 'N' Dale. Is clear, therefore, that if legal title remained with Sloan, it was because beneficial ownership clearly and unambiguously rested first with 310/311 and, post-transaction, with 312.

105 I do not think Mr. Ford intentionally sought to conceal relevant documents. Issues raised during his cross-examination prompted him to search an old precedent file in his basement. He found exhibits 11 and 12. He brought these to court to show Mr. Healey. During that process, plaintiff's counsel got wind of these new documents and aggressively sought access to them. I fault no one for this but Mr. Ford was "spooked" by plaintiff's counsel and took the documents back to his car. His stated purpose in doing so was to enable Mr. Healey to review them in private (and because he had to put more money in his parking meter). My ruling during the trial required the documents to be retrieved and brought into court, where they were reviewed by Mr. Healey and, ultimately, all provided to plaintiff's counsel. They were marked as exhibits in the trial and subject to subsequent cross-examination. The documents show the continuation of what we had seen earlier; Sloan signed documents on behalf of the companies, etc. The new documents, however, are not dispositive of any specific issue in dispute

106 It is true that all of the documents were not perfectly organized or entirely consistent through the process of acquiring Hill 'N' Dale in 1987, transferring it to 312 in 1988 and selling it in 1989. However, as Hunt J. said in *Royal Bank of Canada v. Thiessen*, [1981] M.J. No. 45 at para. 12, "Financial arrangements between husband and wife are often not documented as thoroughly as they are between people acting at arms' length. This does not mean they are not real or that they should not be accepted as factual, or bona fides."

107 In all of the circumstances, I find that Sloan held legal title to Hill 'N' Dale in trust for Valerie. He was not holding title in trust for himself and there was a known, intended beneficiary in his wife, Valerie. While the exact form of that trust was not determined until several months later, the intention was, I find, that Valerie was to hold the ultimate beneficial interest. The delay in implementing that intent was to enable Mr. Ford to structure the transaction in a way that would reduce exposure to tax on any future sale.

108 The plaintiff's second argument rests on the proposition that, in the course of acquiring the Hill 'N' Dale property, Sloan converted his own asset, i.e. money, into an asset beneficially owned by Valerie, i.e., the Hill 'N' Dale property. This transaction was to a closely related party for no consideration. Sloan's subsequent dealings with the property, including to the present, is said to show that he continued to derive benefit from and, to some extent, control this property. These are suspicious circumstances which warrant careful scrutiny.

109 In my view, as with the Bowes property, the issue of whether there was fraudulent intent to defeat creditors in December 1987 essentially turns on the question of whether Sloan ought reasonably to have understood that conveying Hill 'N' Dale beneficially to Valerie was likely to result in his inability to meet his obligations to others as they fell due.

110 The analysis of this issue is similar to the analysis of the Bowes transaction. I am unable to conclude, on the evidence, that in buying the Hill 'N' Dale property for Valerie, Sloan intended, or reasonably ought to have been concerned, that in doing so he would defeat creditors.

111 Indcondo was not a creditor in December 1987. The put/call agreement would not exist for several years into the future. The banks were clearly creditors of Steeles-Jane and Sloan was bound by personal guarantees to cover Steeles-Jane's indebtedness. However, in 1987 and 1988, there is no evidence that Steeles-Jane was in, or heading for, trouble. There is no evidence that the market was turning or that Sloan was embarking on a new, uniquely risky, venture. There is no evidence that any creditor relied on Hill 'N' Dale specifically as security for Sloan's current or possible future obligations.

112 The plaintiff argues that when you take away the investment portfolio and the Hill'N'Dale property, there are no assets remaining to satisfy Sloan's creditors. On this basis, the plaintiff argues that Sloan must have intended that these transfers would leave his creditors with nothing. The flaw in this argument, however, is that it is based entirely on hindsight. In fact, in 1987/88 I find, these assets represented a relatively small proportion of what Sloan would reasonably have believed to be his net worth. To all intents and purposes, Sloan was flying high in 1987/88. He cashed in his Magna investment, acquired Unimade for his own and appeared to be heading for substantial profits arising out of Steeles-Jane's real estate development activities. The plaintiff's argument requires assuming that the failure of Steeles-Jane and Unimade were reasonably foreseeable by Sloan in 1987, 1988 and 1989. I do not think the evidence supports that assumption. The acquisition of the Hill 'N' Dale property beneficially for Valerie was, therefore, not done with intent to defeat Sloan's creditors.

113 If I am wrong in the conclusion that Valerie beneficially owned Hill 'N' Dale and, in fact, Sloan remained the beneficial owner of Hill 'N' Dale until it was sold on April 6, 1989, there remains the question whether, when Hill 'N' Dale was sold, the transfer of the proceeds of that sale to 312 (both cash and vendor takeback mortgage) itself represents a fraudulent conveyance.

114 There are three main factors said to have changed between December 1987 when the Hill 'N' Dale property was acquired and April 1989 when it was sold. First, by year-end May 1989, Steeles-Jane's balance sheet had changed. As of May 31, 1989, Steeles-Jane had assets of about $70 million, including over $40 million of property held for resale or future development. Steeles-Jane had liabilities of almost $67 million with retained earnings of some $3.8 million. The value of Sloan's stake in Steeles-Jane had grown but so had his potential liabilities. April 1989 is only about a year before the put/call agreement was reached, in the period of time Di Poala claims to have been giving dire warnings to the other shareholders of their possible exposure to a downturn and expressing his desire to be cashed out of Steeles-Jane. Finally, 1989 is when Di Poala says the market started to turn.

115 In essence, the plaintiff argues that by April 1989, there were more warning signs and that the potential exposure under Sloan's personal guarantees to the CIBC and the percentage of raw land held by Steeles-Jane (and therefore the more risky part of its real estate portfolio) had grown significantly. Thus, the plaintiff takes the position that by April 1989 Sloan could no longer reasonably have believed that giving his assets to Valerie would not adversely affect his ability to

see that his creditors would be paid.

116 As mentioned earlier, the parties take diametrically opposed views of when the market started to turn and when the collapse of the market was reasonably foreseen or foreseeable. The anecdotal evidence of the parties I find entirely unhelpful. Both sides have their self-interested reasons for placing the downturn earlier or later than the other. Neither party called any expert evidence on this issue. In my view, the best evidence of the buoyancy of the Toronto real estate market has to be taken from the objective evidence of third-party transactions involved in this case.

117 The reporting package to shareholders of Steeles-Jane dated October 25, 1989 shows, as indicated earlier, established equity of almost $48 million, leaving aside budgeted gains on unserviced land. This approach appears to be consistent with the manner in which Indcondo's shares were valued for the purposes of the put/call agreement.

118 In April 1990, a year after the sale of Hill 'N' Dale and the transfer of the proceeds to 312, Indcondo's 10% was agreed to be worth about $5 million, suggesting an underlying assumed net equity value of Steeles-Jane of $50 million. Indcondo is the only shareholder ever to receive a net equity return on its shares in Steeles-Jane. Had the business been in trouble, or on the known brink of trouble, as Di Poala alleges, it is inconceivable to me that all the other shareholders of Steeles-Jane would have agreed in April 1990 to a buy out for Di Poala at a price representing a *net equity value* of Steeles-Jane of $50 million.

119 Further, this value suggests an assumed net equity value of Sloan's 20% interest in Steeles-Jane of $20 million. Thus, in April 1990, Sloan would reasonably have believed based on the market values of the underlying assets, that, after all Steeles-Jane's lenders had been paid, his interest in Steeles-Jane would still have had very substantial value indeed.

120 In addition, in 1988, post-purchase of Hill 'N' Dale, Sloan and Ford thought it worth paying a substantial fee of some $133,000 to structure a transaction the entire purpose of which was to realize current gains against a future sale. This suggests an anticipation that the value would continue to grow. And, in fact, it did grow - the April 1989 sale of the Hill 'N' Dale property to HTB (an arms' length transaction) resulted in a gain of over $5 million over the 1987 purchase price.

121 The put/call agreement was not signed until April 1990. The initial scheduled transaction posed no problem for Alfano and Rinomato, the intended purchasers of Indcondo's Steeles-Jane shares. Indcondo's October 1990 put also resulted in the scheduled purchases by Alfano and Rinomato, albeit some portion of payment for which was later than originally contemplated.

122 It was not until November 1990 that Alfano and Rinomato gave indemnities to Sloan and not until April 1991 that Alfano and Rinomato defaulted on their scheduled purchases of Indcondo's Steeles-Jane shares. It was not until March 1992 that Indcondo served notice of its intention to require Sloan to purchase all of Indcondo's Steeles-Jane shares and only in April 1992 that Indcondo commenced an action to enforce this obligation (an action in respect of which it did

essentially nothing for four years).

123 Another factor worthy of consideration in the analysis of this issue is the timing of Di Poala's release from his own personal guarantees of Steeles-Jane's indebtedness to its lenders. As noted in the put/call agreement, Indcondo and Di Poala had provided guarantees to various mortgagees in the amount of $22.8 million and to CIBC for $5.5 million (10% of $55 million). As of April 6, 1990, there was approximately $37.2 million of indebtedness owed to the CIBC (10% of which was $3.72 million).

124 Under the put/call agreement, Steeles-Jane agreed to use its best efforts to obtain releases for Indcondo and Di Poala from their guarantees to the lenders and indemnified Indcondo and Di Poala in respect of all guarantees given by them.

125 The evidence was that sometime after April 6, 1990, Di Paola and Indcondo were, in fact, released by the lenders from the obligations under their guarantees. There was no evidence provided about the specific timing or circumstances of obtaining these releases. However, it seems to me inconceivable that, if there had been any hint of Steeles-Jane's financial difficulty or possible inability to discharge its debts to the financial institutions, the release of Indcondo and Di Poala's guarantees could have been obtained in any circumstances.

126 Accordingly, the only possible inference from the lender's conduct in agreeing to release Indcondo and Di Poala from their guarantees is that by, at least April 6, 1990, and most likely for some time after that, Steeles-Jane's creditors were satisfied with Steeles-Jane's balance sheet and unconcerned about the sufficiency of their security for Steeles-Jane's obligations.

127 In my view, on the evidence, the earliest sign of market difficulty can be placed no earlier than November 1990, a year and a half after 312 received the benefit of the proceeds of sale of the Hill 'N' Dale property. At the time of that transfer in April 1989, therefore, Sloan had every reason to believe, reasonably, that the transfer of the benefit of the sale of Hill 'N' Dale to 312/Cave Hill would not impair his ability to make good on his other financial obligations.

128 For these reasons and those previously stated, I do not think Sloan could be said to have had the required intent to defraud creditors in April 1989. I therefore find that, even if Sloan remained the owner of the Hill 'N' Dale property until it was sold in April 1989, the transfer of the proceeds of that sale to 312 was not done with the intent to defraud creditors.

5. The Riverside Property

129 Sloan and Valerie purchased 42 Riverside as joint tenants in August 1989. Their prior home was also owned in joint tenancy. On July 8, 1992, Sloan conveyed his 50% interest in 42 Riverside to Valerie.

130 The context for this transaction is materially different from those discussed above. By at least

early 1991, Alfano and Rinomato defaulted on their obligation to purchase Indcondo's shares in Steeles-Jane. Indcondo served notice of its call on Sloan to acquire its shares in March 1992. When the shares were not purchased, Indcondo issued a statement of claim in May 1992. The details are vague but it is known as well that somewhere between 1990 and 1992, CIBC, the Royal Bank of Canada and the Bank of Nova Scotia began "putting pressure" on Sloan in respect of his personal guarantees. The Royal Bank sued Sloan and apparently obtained judgment for $12 million in 1993. I find that this "pressure" likely became manifest in late 1991.

131 Sloan had initially transferred his interest in 42 Riverside to Valerie in 1990 for no consideration. He received advice later, however, that the transfer of this interest without consideration was liable to be set aside and so the transfer was reversed. By July 1992, the Bank of Nova Scotia was pressing Sloan for repayment of a $500,000 line of credit. Mr. Ford's evidence was that he discussed the matter with Sloan and Valerie. Valerie, he said, wanted to help Sloan was unwilling to mortgage 42 Riverside. Mr. Ford recommended pursuing a tax efficient transaction in which Valerie would acquire Sloan's interest in 42 Riverside in exchange for causing Cave Hill to pay off Sloan's Scotiabank indebtedness. Sloan and Valerie followed this advice.

132 Sloan and Valerie obtained an appraisal of 42 Riverside, valuing the property at $1,050,000. Cave Hill raised $500,000 by agreeing with HTB, the purchaser of the Hill 'N' Dale property, in exchange for a reduction of its vendor takeback mortgage to HTB of $900,000, to a prepayment on the mortgage of $500,000. This money was used to pay off Sloan's obligation to Scotiabank. The remaining $25,000 was paid to Sloan in cash. Title to Sloan's interest in 42 Riverside, therefore, passed to Valerie in exchange for consideration of half the appraised value, $525,000.

133 The plaintiff attacks the transfer of Sloan's interest in the matrimonial home on the basis that:

(a) the transfer was made to a non-arms' length person;
(b) consideration was inadequate or nonexistent;
(c) the debtor continued in possession of the property after the conveyance;
(d) there were actual and potential liabilities facing the transferor at the time of the transfer; and
(e) the transfer forms part of a pattern of conduct.

134 The defendants seek to justify this transaction on the basis that the defendants had a continuing intention to transfer Sloan's interest to Valerie since 1990 (that is, from before the market collapse) and on the basis that the transaction was done for valuable consideration.

135 I do not think the fact that an earlier attempt, perhaps in more favourable circumstances, to transfer Sloan's interest in 42 Riverside to Valerie can save the transaction from attack. The law is clear that the time for evaluating fraudulent intent is at the time of the impugned transaction. Thus, hindsight does enter into the analysis.

136 Sloan knew by July 1992 that he was in significant financial jeopardy, not only to the Bank

of Nova Scotia but to Steeles-Jane's lenders, Unimade's lenders and, potentially, to Indcondo as well. He also knew that at least some of his others assets had been given to Valerie. In the circumstances, I can come to no other conclusion but that Sloan knew, or ought to have known, that the transfer of his interest in 42 Riverside to Valerie in 1992 would be likely to have a material adverse impact on his ability to pay his creditors. Indeed, in the circumstances, I find that this was the very reason the transaction was done.

137 This leaves the issue of consideration. The defendants say that Valerie, through her company, 312, paid valuable consideration to Sloan in the form of satisfaction of Sloan's obligation to the Bank of Nova Scotia. They argue that consideration cures all, rendering valid what would otherwise be an attack-able transaction. The plaintiff argues that there was no consideration at all or that, if there was any consideration, it was grossly inadequate. The plaintiff first argues that the assets of 312 were, in fact, Sloan's assets, such that Sloan simply paid himself funds for the reduction of the Scotiabank indebtedness. In the alternative, the plaintiff argues that, since 312 was itself on the hook to Scotiabank as guarantor of Sloan's indebtedness, the payment of $500,000 to the Bank of Nova Scotia was not consideration paid to Sloan for his half interest in 42 Riverside but, rather, a payment to reduce indebtedness of its own which 312 already had. The remaining consideration paid, $25,000 in cash, was grossly inadequate given the evidence of a valuation of the property at $1,050,000. Finally, the plaintiff argues that even with consideration, the 1992 transfer of Sloan's interest in 42 Riverside to Valerie constitutes, in the circumstances, a fraud on his creditors.

138 I am not persuaded by the plaintiff's first argument. For the reasons outlined earlier, I find that Valerie was the sole owner of 312 and, therefore, had the ultimate financial benefit of 312's assets. If Valerie wanted to spend 312's money bailing out Sloan from his personal financial difficulties, that was her prerogative. I accept that, absent the issue of fraudulent intent to defeat creditors, the deal as proposed by Mr. Ford was a valid one.

139 I agree, however, with the plaintiff's second and third arguments. On February 27, 1990, 312 executed an unlimited guarantee of Sloan's obligations to the Bank of Nova Scotia. The evidence is that Sloan was being pressed by the Bank of Nova Scotia in 1992 for payment of Sloan's obligations to the bank. While Valerie seeks to characterize 312's payment of $500,000 to the bank as consideration for Sloan's interest in the matrimonial home, in reality the payment was necessary to avoid 312's own liability under its guarantee. That payment, therefore, in the circumstances cannot be considered valid consideration for Sloan's half interest in 42 Riverside. The remaining aspect of the payment, $25,000, was grossly inadequate.

140 Even if 312's payment in respect of Sloan's obligation to Scotiabank could have been considered valid consideration for the transfer of Sloan's interest in the matrimonial home, in the circumstances that existed by mid-1992, I would have found the transaction invalid in any event.

141 This is because even where the court determines that there is good and valuable consideration, it may still find that the conveyance was fraudulent if:

(a) it was not done in good faith; and
(b) it was made to a person with knowledge of the debtor's intent to defraud.

142 Section 3 of the *Fraudulent Conveyances Act* provides that good consideration is a defence to a fraudulent conveyance action *provided that* the conveyance was done "in good faith to persons not having at the time of the conveyance to the person notice or knowledge of" the fraudulent intent. Given the close relationship Sloan enjoyed with Valerie, emphasized repeatedly throughout his evidence, and the extent of the business dealings in which Valerie was already engaged with the family unit's assets, it is inconceivable that Valerie was not aware of Sloan's financial problems by July 1992. I find that Valerie must have known that the chief purpose of the transfer of Sloan's interest in 42 Riverside was to protect their home against execution by Sloan's creditors.

143 For these reasons, I find that the transfer of Sloan's interest in 42 Riverside to Valerie in July 1992 was done with the intent to defeat Sloan's creditors and must, on this basis, be set aside.

6. The Florida Condominium

144 Sloan purchased a Florida condominium in 1981 in his own name and using his own money. In 1993, Sloan conveyed 50% of his interest in this property to Valerie for no consideration. In April 1994, the condominium was sold for $275,000. The proceeds of sale went to Valerie personally or to Cave Hill. The explanation for this transfer at trial was simply that Valerie asked Sloan to do it this way.

145 In my view, the same analysis applying to 42 Riverside applies to the Florida condominium. The condominium was clearly Sloan's asset. The transfer of a half interest to Valerie in 1993 and the transfer of the entire proceeds of sale to Cave Hill (or Valerie) in 1994 were done at time when Sloan had been sued, not only by the plaintiff but by the Royal Bank of Canada as well. The badges of fraud in this case overwhelming point to fraudulent intent. The defendants have not overcome their evidentiary, or tactical, burden of providing a plausible explanation justifying the validity of this transfer.

146 For these reasons, the transfer of the proceeds of sale, in the amount of $275,000, to Cave Hill must be set aside. There being no evidence of the amount of any encumberance on this property, the full amount of the proceeds must be considered available for Sloan's creditors.

The Evidence of Tony Di Poala

147 The plaintiff's only other witness besides John Di Poala was his brother, Tony Di Poala. Tony gave evidence about a conversation he had with Sloan in September 1991, in which the subject of the plaintiff's pending action came up. During the conversation, Sloan is alleged to have said that he was taking steps to make himself judgment-proof, as were the other shareholders, and that this was what businessmen do when faced with threatened litigation.

148 I do not find this evidence to be especially probative or compelling. First, as John Di Poala's brother, Tony has an obvious "stake" in these proceedings; he is not an entirely independent witness. Second, this evidence involves events that happened 23 years ago. For this reason, I do not find either the specific content or the specific timing of the conversation particularly reliable. Most importantly, however, even if I were to accept Tony's evidence, it does little more than tend to corroborate conclusions I have already reached based on other, more objective evidence. The conversation, on Tony's own evidence, took place in the fall of 1991. The Bowes and Hill 'N' Dale property transactions had already taken place. At best, therefore, Tony's evidence is relevant to the transfers of 42 Riverside and the Florida condominium, which I have already found, on the basis of other evidence, were invalid as having been undertaken with the intent to defeat Sloan's creditors. For these reasons, I have placed little weight on Tony's evidence.

Piercing the Corporate Veil

149 The plaintiff also argues that, in addition to the specific transactions attacked under s. 3 of the *Fraudulent Conveyances Act*, it is entitled to trace all of Sloan's assets to Cave Hill in order to satisfy its judgment. The plaintiff claims, in the circumstances of this case, that it is entitled to pierce the corporate veil.

150 In essence, the plaintiff argues that Cave Hill has, since 1988, operated as little more that Sloan's personal bank account. Put simply, the plaintiff says that Sloan's name is all over Cave Hill's transactions since its formulation as 938 and 312. It was Sloan who, in reality, was the directing mind of Cave Hill's activities. All of Cave Hill's assets came from Sloan for no consideration. Yet now that Sloan is insolvent, these assets have been removed from the reach of Sloan's creditors. Even Sloan's consulting income in the 1990s was deposited into Cave Hill's account for no consideration. The assets of Cave Hill continue to provide the cash for money transfers to Sloan and Valerie's joint bank account, which funds all of not only Valerie's but Sloan's ongoing living expenses. Sloan does not even need, the plaintiff says, to go through the charade of having Valerie (as sole Cave Hill shareholder) authorize these transfers because, at least since Valerie's stroke, Sloan has held her power of attorney for property and Sloan's old friend, Mr. Pender, is the business manager of Cave Hill. Cave Hill is, argues the plaintiff, a flagrant abuse of the corporate form.

151 I take the definitive, and most current, formulation of the principles underlying when the corporate veil may be pierced from the decision of Sharpe J. (as he then was) in *Transamerica Life Insurance Co. of Canada v. Canada Life Assurance Co.* 1996 CarswellOnt 1699 at paras. 22 and 23:

> ...the courts will disregard the separate legal personality of a corporate entity where it is completely dominated and controlled and being used as a shield for fraudulent or improper conduct. The first element, "complete control", requires more than ownership. It must be shown that there is complete domination and that the subsidiary company does not, in fact, function independently...

> The second element relates to the nature of the conduct: is there "conduct akin to fraud that would otherwise unjustly deprive claimants of their rights?"

152 Sharpe J. relied on the prior decision of the Ontario Court of Appeal in *Gregorio v. Intrans Corp.* (1994), 18 O.R. (3d) 527, a decision of Laskin J.A., at p. 536:

> Generally, a subsidiary, even a wholly-owned subsidiary, will not be found to be the alter ego of its parent unless the subsidiary is under the complete control of the parent and is nothing more than a conduit used by the parent to avoid liability. The alter ego principle is applied to prevent conduct akin to fraud that would otherwise unjustly deprive claimants of their rights.

153 An appeal from the decision of Sharpe J. was dismissed by the Court of Appeal in a brief endorsement at 1997 CarswellOnt 3496. See also *Fleisher v. 642947 Ontario Limited*, [2001] O.J. No. 4771 at para. 68.

154 In my view, the corporate veil argument adds nothing to the analysis of the situation here. The corporate veil argument cannot succeed separate and apart from the issue of fraudulent conveyances.

155 I say this because, while I would be prepared to accept that Sloan sufficiently dominated the affairs of Cave Hill to meet the first part of the test, the basis for the alleged fraudulent conduct which has deprived the claimant of its rights under the second part of the test is the same conduct on which the plaintiff relies to set aside the impugned transfers as fraudulent conveyances of property dealt with earlier in these Reasons. Thus, the corporate veil argument adds nothing and has no effect apart from the specific transactions which are under attack and which have been dealt with on their own merits.

156 For this reason, I dismiss the plaintiff's claims relating to piercing the corporate veil.

<u>The Defence of Laches</u>

157 Laches is an equitable doctrine, akin to estoppel, founded on the principle that one is obliged to assert legal rights in a timely way or risk losing them. Laches is a form of equitable limitation period. Two factors dominate the consideration of this doctrine:

(1) delay and its circumstances; and
(2) prejudice resulting from that delay.

158 In *Lindsay Petroleum Co. v. Hurd* (1874), L.R. 5 P.C. 221 at 239-240 the principle was stated as follows:

> ...[it] is not an arbitrary or technical doctrine... Two circumstances, always important in such cases, are, the length of the delay and the nature of the acts done during the interval, which might affect either party and cause a balance of justice or injustice in taking the one course or the other, so far as relates to the remedy.

159 The Supreme Court of Canada discussed these critical factors in *M. (K.) v. M. (H.),* [1992] 3 S.C.R. 6 at pp. 77-78:

> What is immediately obvious from all of the authorities is that mere delay is insufficient to trigger laches... Rather, the doctrine considers whether the delay of the plaintiff constitutes acquiescence or results in circumstances that make the prosecution of the action unreasonable. Ultimately, laches must be resolved as a matter of justice as between the parties, as is the case with any equitable doctrine.

160 In this case, the defendants argue that the plaintiff's action should be dismissed on the basis of laches. The defendants argue that there has been inordinate delay (now 23 years) and prejudice resulting from that delay. The prejudice, it is said, is the presumed prejudice of fading memories over time and the loss or destruction of relevant documents.

161 In respect of the delay, the defendants rely, among other things, on the conclusions of Mesbur J. in her ruling of August 30, 2011 in this case when she said:

> When I look at all the facts of this case and its tortured history, I can come to no other conclusion than that it is an abuse of the court's process. I cannot see how Indcondo can purport to pursue the identical claims yet again, particularly in light of its inordinate delay.

162 I note, however, that central to Mesbur J.'s conclusion in this ruling was the finding that the plaintiff's action was an abuse process - a conclusion founded on the further conclusion that the plaintiff's claim was precluded by the principle of issue estoppel. That central finding on issue estoppel was, however, reversed by the Court of Appeal, which found that, because in *this* case the plaintiff stood in the shoes of the Trustee, it was not seeking to re-litigate earlier, dismissed claims which had been advanced by the plaintiff in its own capacity.

163 Nevertheless, I would be prepared to conclude that the plaintiff has been guilty of inordinate delay in the prosecution of its claims, whether or not those claims are asserted on its own behalf or standing in the shoes of the Trustee. This finding alone, however, as noted above, is insufficient to support a claim of laches. The defendants must also prove circumstances, such as irredeemable prejudice, which show that the continued prosecution of this action is unreasonable. The defendants have failed to do so in this case.

164 In my view, the prejudice relied on - fading memories and loss of documents - lacks

sufficient specificity. While the plaintiff is unquestionably guilty of delay, all parties must take some responsibility for aspects of the more than 23 years which has elapsed since the relevant events. More importantly, while Sloan makes the generic claim that documents were lost or destroyed in the usual and ordinary course of business, there is no evidence of specific documents being destroyed at specific stages of the proceeding as a result of the plaintiff's delay. The relevant property transfers took place between 1987 and 1989. Sloan was first notified of claims in early 1992. Sloan has failed to give any content to the generic complaint that documents that would have been helpful to him were lost or destroyed before that point in time. Since then, while there have been long periods of inactivity on the plaintiff's part, only a fool would have jettisoned important documents with litigation hanging over his head. The fact that Mr. Ford (while not a party nevertheless a friend of Sloan's) produced documents at the eleventh hour also casts some doubt on the rigor with which Sloan fulfilled his document production obligations. While I am sympathetic to the defendants' plea that adverse inferences ought not to be drawn from the loss or destruction of relevant document in the circumstances of this case, the evidence does not rise to the level of proof of acquiescence or actual, material prejudice sufficient to support a claim of laches. For these reasons, the defendants' argument for the dismissal of this action on the basis of laches is dismissed.

CPL Motion

165 The defendants had a pending motion before this court to set aside an *ex parte* order for a certificate of pending litigation based on alleged incomplete disclosure by the plaintiff. This motion, it seems, was overtaken by other events including the two motions to dismiss the action, and the two trips to the Court of Appeal, and the case management order of D. Brown J., which suspended all motions and reserved this issue to trial.

166 The *ex parte* motion was for an interlocutory order, the sole purpose of which was to prevent the dissipation of assets in dispute pending the trial of this action. There has now been, of course, a full hearing on the merits of the plaintiff's claims and, subject to rights of appeal, a final determination of those claims. In my view, therefore, the issue of the sufficiency of the evidence on the plaintiff's *ex parte* motion for a CPL is now moot. I therefore find it unnecessary to rule on the defendants' motion to set aside the CPLs. Any CPL affecting Hill 'N' Dale must and shall be discharged. Any CPL affecting 42 Riverside has been superceded by my judgment.

167 Should there be an appeal, any further motions to preserve assets pending appeal will have to be brought on fresh evidence which would include the evidence adduced at trial.

Costs

168 Any party seeking its costs shall do so by filing a written submission, not to exceed five typed, double-spaced pages, together with a Bill of Costs and supporting documents, within 21 days of the release of these Reasons. Anyone wishing to respond to such a request shall do so by filing a written response, subject to the same page limit, within a further 14 days.

M.A. PENNY J.

TAB 8

Case Name:

Nortel Networks Corp. (Re)

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 Nortel Networks Corporation, Nortel Networks Limited, Nortel Networks Global Corporation, Nortel Networks International Corporation and Nortel Networks Technology Corporation, Applicants
APPLICATION UNDER the Companies' Creditors Arrangement Act, R.S.C. 1985, c. C-36, as amended

[2009] O.J. No. 3425

76 C.C.P.B. 307

2009 CarswellOnt 4806

57 C.B.R. (5th) 232

179 A.C.W.S. (3d) 801

Court File No. 09-CL-7950

Ontario Superior Court of Justice
Commercial List

G.B. Morawetz J.

Heard: June 16, 2009.
Judgment: August 18, 2009.

(41 paras.)

Bankruptcy and insolvency law -- Proceedings -- Practice and procedure Stays -- Of concurrent proceedings -- Motion by corporations for order extending stay to individual defendants in American action allowed and motion by employees of corporations for order lifting stay to allow American action to continue dismissed -- Employees brought action against corporations and

individual defendants, who were officers and directors of corporations, alleging breach of duty in management of retirement plan, which was stayed against corporations as a result of Chapter 11 proceedings -- Action fell within terms of stay as allegations against individual defendants not restricted to actions as fiduciaries -- Employees not prejudiced as stay would only postpone action for short time.

Statutes, Regulations and Rules Cited:

Companies' Creditors Arrangement Act, R.S.C. 1985, c. C-36, s. 11.5, s. 11.5(1), s. 11.5(2)

Employee Retirement Income Security Act, 1974,

Rules of Civil Procedure, Rule 21

Counsel:

Alan Merskey, for Nortel Networks Corp. et al.

Lyndon Barnes and Adam Hirsh, for the Board of Directors of Nortel Networks Corporation and Nortel Networks Limited.

Leanne Williams, for Flextronics Inc.

J. Pasquariello, for Ernst & Young Inc., Monitor.

B. Wadsworth, for CAW-Canada.

Thomas McRae, for Recently Severed Calgary Employees.

(A) McKinnon, for the Former Employees.

Mary Arzoymanidis, for Bell Canada.

Alex MacFarlane, for the Unsecured Creditors' Committee.

Gavin Finlayson, for the Noteholders.

Tina Lie, for the Superintendent of Financial Services of Ontario.

Steven Graff and Ian Aversa, for the Current and Former Employees.

ENDORSEMENT

1 **G.B. MORAWETZ J.**:-- This endorsement relates to two motions.

2 The first is brought by the Applicants for an order extending the stay contained at paragraphs 14-15 and 19 of the Amended and Restated Initial Order (the "Initial Order") to the individual defendants (the "Named Defendants") in the action commenced in the United States District Court, Middle District of Tennessee, Nashville District (the "ERISA Litigation").

3 The second is brought by the current and former employees of Nortel Networks Inc. ("NNI") who are or were participants in the long-term investment plan sponsored by NNI (the "Moving Parties") for an order, if necessary, lifting the stay of proceedings provided for in the Initial Order for the purpose of allowing the Moving Parties to continue with the ERISA Litigation.

4 For the following reasons, the motion of the Applicants is granted and the motion of the Moving Parties is dismissed.

Background

5 The motion of the Applicants is supported by the Board of Directors of Nortel Networks Corp. ("NNC") and Nortel Networks Ltd. ("NNL"), the Monitor, the Unsecured Creditors' Committee and the Bondholders.

6 The ERISA Litigation involves the alleged breach by the Named Defendants of their statutory duties under the *Employee Retirement Income Security Act, 1974* ("ERISA") regarding the management of NNI's defined contribution retirement plan (the "Plan"). It is alleged that, among others, the Named Defendants breached their duty by imprudently offering NNC stock for investment in the Plan.

7 The ERISA Litigation is currently at the discovery stage, which entails a review and production of millions of pages of electronic documents and numerous depositions. The ERISA Litigation plaintiffs are entitled to conduct up to 60 depositions.

8 Counsel to the Moving Parties explained that the defendants in ERISA cases are typically the individuals who managed the plan, being the "fiduciaries" in the language of ERISA. The fiduciaries may include the corporate entity itself, senior management employees, human resources employees and/or other personnel, entities or persons outside the company, or any combination of same. Counsel submits that under ERISA, the status of an individual as a fiduciary depends on the plan documents and the actual management and practice relating to the plan, not an individual's official corporate status as an officer and/or director of the plan's sponsor.

9 Although the intent of the ERISA action may be aimed at the individuals in their capacity as independent ERISA fiduciaries, it seems to me that the Second Amended Complaint ("SAC") as

filed in the action has a much broader impact.

10 At paragraph 15 of his factum, Mr. Barnes makes the following submission:

> It is simply untenable to suggest that the D&O Defendants [referred to herein as the "Named Defendants"] are only being sued in their capacity as independent ERISA fiduciaries. This claim is belied by the Plaintiff's own pleadings. The Second Amended Consolidated Class Action Complaint ("SAC") repeatedly asserts claims against the Named Defendants that specifically relate to the obligations of the company, where the defendants are alleged to be liable in their capacities as directors or officers. For example, the Plaintiffs allege that Nortel "necessarily acts through its Board of Directors, officers and employees", and assert that the "directors-fiduciaries act on behalf of [Nortel]". The SAC further claims that the Named Defendants are liable as "co-fiduciaries" alongside the company. It is inescapable that some of the claims for which the plaintiffs seek to recover against the individual Named Defendants relate to obligations of Nortel, because, as is evident from multiple allegations in the SAC, Nortel can only act derivatively through its directors and officers.

11 Mr. Barnes cites references to the SAC at page 5, paragraph 14; page 6, paragraph 19; pages 24, 52, 54 and paragraphs 50-109, 114; and pages 26 and 35 and paragraphs 58 and 66.

12 Mr. Barnes goes on to submit that as a result, the allegations in the ERISA Litigation against the Named Defendants and the allegations against the corporate defendants are invariably intertwined, raising several identical questions of fact and law.

13 Mr. Barnes also made reference to paragraph 147 of the SAC which sets out the additional theory of liability against some of the Defendants and alleges in the alternative that the said defendants are liable as non-fiduciaries who knowingly participated in the fiduciary breaches of the other Plan fiduciaries described herein, for which said Defendants are liable pursuant to ERISA.

14 Although the ERISA Litigation may be aimed at the Named Defendants in their capacities as "fiduciaries" it seems to me that this distinction is somewhat blurred such that it is arguable that the Named Defendants only have fiduciary status under ERISA as a consequence of their position as directors or officers of the company.

15 The Moving Parties concede that the ERISA Litigation against NNI, NNC and NNL is stayed as a result of the Chapter 11 proceeding, the Initial Order, and the Chapter 15 proceedings. The Moving Parties seek to continue the action as against the Named Defendants and carry on with the discovery process.

16 The Moving Parties stated intention in continuing with the ERISA Litigation is to pursue insurance proceeds. The Moving Parties have filed evidence of an offer to settle made within the

limits of the applicable policies but the offer has not been accepted.

17 The Moving Parties take the position that the ERISA Litigation is not stayed as against the Named Defendants pursuant to the stay because the Named Defendants are "not being sued in their capacity as officers and directors of the two Canadian corporations, but in their capacities as fiduciaries of an American 401(k) Plan". The Applicants take the position that it is, however, as a result of their employment by the Applicants that the Named Defendants had any capacity as fiduciaries for an American 401(k) Plan.

18 The Moving Parties take the position that a continuation of the ERISA Litigation will have a minimal effect on the Applicants because, among other things:

(a) the documentary discovery can be managed by the lawyers without the extensive involvement of any Nortel personnel;
(b) the bulk of documentary discovery issues have been worked out;
(c) they will accommodate individual defendants involved in the restructuring efforts by scheduling the remaining steps in the ERISA Litigation so that they are not distracted from the restructuring efforts; and
(d) they will agree that any determination or adjudication shall be without prejudice to the Canadian applicants in the claims process.

19 The Applicants take the position that they do not wish to be drawn into the conflict over the insurance proceeds as this would result in prejudice to their restructuring efforts. At this time, the Applicants are at a critical stage of their restructuring and submit that their efforts should be directed towards the restructuring.

20 Mr. Barnes submits that, if the ERISA Litigation is allowed to continue, it will detract significant attention and resources from Nortel's restructuring. The Moving Parties are seeking continued discovery of millions of pages of electronic documents in the company's possession and are expected to conduct dozens depositions. Mr. Barnes further submits it is simply not the case that continued litigation has a minimal effect on the company as negotiating a discovery agreement and collecting and providing the documents in question requires considerable time and resources in preparing past and current directors and officers for the depositions which will necessitate significant attention and focus for management and the board. In addition, he submits that addressing the strategic issues raised by the litigation, including the prospect of settlement, requires the attention of management and the board. Further, as the questions of fact and law at issue in the ERISA Litigation are practically identical as between the corporate defendants and the D&O Defendants, he submits there is a serious risk of the record being tainted if the action proceeds without the Applicants' participation, which could have corresponding effects on any claims process.

21 It is also necessary to take into account the effect of a stay of the ERISA Litigation on the Moving Parties.

22 As counsel to the Applicants points out, the Moving Parties have also stated that their primary interest in continuing the ERISA Litigation is to pursue an insurance policy issued by Chubb. The Moving Parties have noted that the insurance proceeds are a "wasting policy", starting at U.S. $30 million and declining for defence costs.

23 Counsel to the Applicants submits that in the event that the stay continues, few defence costs will be incurred against the insurance proceeds and the Moving Parties will maintain the value of their within limits offer.

24 Further, as Mr. Barnes points out, staying the entire ERISA Litigation would not significantly harm the Moving Parties as it does not preclude their action, but merely postpones it.

Analysis

25 Section 11.5 of the CCAA authorizes the court to make an order under the CCAA to provide for a stay of proceedings against directors. Section 11.5(1) states:

> 11.5(1) An order made under section 11 may provide that no person may commence or continue any action against a director of the debtor company on any claim against directors that arose before the commencement of proceedings under this Act and that relates to obligations of the company where directors are under any law liable within their capacity as directors for the payment of such obligations, unless a compromise or arrangement in respect of the company, if one is filed, is sanctioned by the court or is refused by the creditors or the court.

26 Section 19 of the Initial Order provides as follows:

> THIS COURT ORDERS that during the Stay Period, and except as permitted by subsection 11.5(2) of the CCAA, no Proceeding may be commenced or continued against any of the former, current or future directors or officers of the Applicants with respect to any claim against the directors or officers that arose before the date hereof and that relates to any obligations of the Applicants whereby the directors or officers are alleged under any law to be liable in their capacity as directors or officers for the payment or performance of such obligations, unless a compromise or arrangement in respect of the Applicants, if one is filed, is sanctioned by this Court or is refused by the creditors of the applicant or this Court (the "D&O" stay).

27 It is also argued by both counsel to the Applicants and the Board that this statutory power is augmented by the court's inherent jurisdiction to grant a stay in appropriate circumstances. (See: *SNV Group Limited (Re)*, [2001] B.C.J. No. 2497 (S.C.).) Counsel to the Applicants and the Board also submit that the CCAA is remedial legislation to be construed liberally and in these circumstances, it should be recognized that the purpose of the stay is to provide a debtor with its

opportunity to negotiate with its creditors without having to devote time and scarce resources to defending legal actions against it. It is further submitted that given that a company can only act through its management and board, by extension, the purpose of the stay provision is to provide management and the board with the opportunity to negotiate with creditors and other stakeholders without having to devote precious time, resources and energy to defending against legal actions.

28 Mr. Barnes submits that the ERISA Litigation falls squarely within the terms of the D&O Stay as it is a claim against former and current directors and officers under a U.S. statute that arose prior to the date of filing. Further, the Named Defendants are only exposed to this liability as a consequence of their position with the company.

29 It is on this last point that Mr. Graff, on behalf of the Moving Parties, takes issue. He submits that the litigation is not stayed against the individual defendants because they are not being sued in their capacities as officers and directors of two Canadian corporations, but in their capacities as fiduciaries of an American 401(k) Plan. As such, he submits that the stay ought not to extend to the ERISA Litigation. He submits that the named defendants' liability is not a derivative of the Applicants' liability, if any, as a fiduciary. He further submits that the corporate defendants have claimed in the ERISA Litigation that the corporate entities are not fiduciaries at all and need not even have been named in the ERISA Litigation.

30 Mr. Graff further submits that the Applicants' submission and the Board's submission is flawed and that following the reasoning of the Court of Appeal in *Morneau Sobeco Limited Partnership v. Aon Consulting Inc.* (2008), 40 C.B.R. (5th) 172 (Ont. C.A.), the fact that the management of the Plan has always been performed by the Applicants' employees, officers and directors is moot. Mr. Graff submits that the *Morneau* case is on "all fours" with this case.

31 With respect, I do not find that the *Morneau* case is on "all fours" with this case. Mr. Graff submits that in *Morneau*, the Court of Appeal opined on the applicable legal questions: When are directors and officers not directors and officers?

32 In my view, while the Court of Appeal may have commented on the issue referenced by Mr. Graff, it was not in a context which is similar to that being faced on this motion. In *Morneau*, the Court of Appeal was faced with an interpretation issue arising out of the scope and terms of a release. The consequences of an interpretation against Morneau would have resulted in a bar of the claim. This distinction between *Morneau* and the case at bar is, in my view, significant.

33 The *Morneau* case can also be distinguished on the basis that Gillese J.A. was examining a release and, in particular, how far that release went. That is not an issue that is before me. There is no determination that is being made on this motion that will affect the ultimate outcome of the ERISA Litigation. There is no issue that a denial of the stay will result in the action being barred. Rather, the effect of the stay would be merely to postpone the ERISA Litigation.

34 This is not a Rule 21 motion and accordingly, the pleadings do not have to be reviewed on the

basis as to whether it is "plain, obvious and beyond doubt" that the claim could not succeed. In this case, there is no "bright line" in the pleadings. As I have noted above, the allegations against the Named Defendants are not restricted to the defendants acting in their capacity as fiduciaries. In expanding the scope of the litigation to include broad allegations as against the directors, the Moving Parties have brought the ERISA Litigation, in my view, within the terms of the D&O Stay.

35 Having determined that the ERISA Litigation falls within the terms of the D&O Stay, the second issue to consider is whether the stay should be lifted so as to permit the ERISA Litigation to continue at this time.

36 In my view, the Nortel restructuring is at a critical stage and the energies and activities of the Board should be directed towards the restructuring. I accept the argument of Mr. Barnes on this point. To permit the ERISA Litigation to continue at that time would, in my view, result in a significant distraction and diversion of resources at a time when that can be least afforded. It is necessary in considering whether to lift the stay, to weigh the interests of the Applicants against the interests of those who will be affected by the stay. Where the benefits to be achieved by the applicant outweighs the prejudice to affected parties, a stay will be granted. (See: *Woodwards Limited (Re)* (1993), 17 C.B.R. (3d) 236 (B.C.S.C.).)

37 I also note the comments of Blair J. (as he then was) in *Campeau v. Olympia & York Developments Ltd.* (1992), 14 C.B.R. (3d) 303 (Ont. Gen. Div.) at paragraph 24 where he stated:

> In making these orders, I see no prejudice to the Campeau plaintiffs. The processing of their action is not being precluded, but merely postponed. Their claims may, indeed, be addressed more expeditiously than might have otherwise been the case, as they may be dealt with -- at least for the purposes of that proceeding in the CCAA proceeding itself.

38 The prejudice to be suffered by the Moving Parties in the ERISA Litigation is a postponement of the claim. In view of the fact that the ERISA Litigation was commenced in 2001, I have not been persuaded that a further postponement for a relatively short period of time will be unduly prejudicial to the Moving Parties.

Disposition

39 Under the circumstances, I have concluded that the D&O Stay under the Initial Order does cover the D&O Defendants in the ERISA Litigation and that it is not appropriate to lift the stay at this time.

40 It is recognized that the ERISA Litigation will proceed at some point. The plaintiffs in the ERISA Litigation are at liberty to have this matter reviewed in 120 days.

41 To the extend that I have erred in determining that the ERISA Litigation is not the type of

action directly contemplated by the D&O Stay, I would exercise this Court's inherent power to stay the proceedings against non-parties to achieve the same result.

G.B. MORAWETZ J.

TAB 9

Case Name:

Puratone Corp. (Re)

**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 the Puratone Corporation, Pembina Valley Pigs Ltd. and Niverville Swine Breeders Ltd., (the "Applicants") Application Under: the Companies' Creditors Arrangement Act, R.S.C. 1985, C. C-36, as Amended**

[2013] M.J. No. 247

2013 MBQB 171

295 Man.R. (2d) 55

Docket: CI 12-01-79231

Manitoba Court of Queen's Bench
Winnipeg Centre

R.A. Dewar J.

Judgment: July 8, 2013.

(41 paras.)

Counsel:

David Jackson, for Puratone Corporation.

J.J. Burnell, for Bank of Montreal.

Jeffrey Lee and Sandra Zinchuk, for Farm Credit Canada.

Richard Schwartz and Jason Harvey, for ITB Claimants.

Ross McFadyen, for Deloitte Touche Inc.

David Kroft and Aaron Challis, for Directors and Officers.

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1 **R.A. DEWAR J.**:-- On September 12, 2012, an Initial Order was pronounced by me in a proceeding under the ***Companies' Creditors Arrangement Act***, R.S.C., 1985, c. C-36 (the "CCAA") filed on that date by three of the companies within the Puratone umbrella, namely The Puratone Corporation, Pembina Valley Pigs Ltd., and Niverville Swine Breeders Ltd. (hereinafter "Puratone").

2 The Puratone Group of companies ran a commercial hog production business. Their business included the breeding, farrowing, finishing and marketing of hogs. In order to carry on this business, Puratone needed grain to be used in feed for its hogs.

3 This motion involves 17 farming operators who claim priority to some of the proceeds of sale of the assets of the companies covered by the within CCAA proceedings. The lead farming operator, Interlake Turkey Breeders Ltd. claims to be a part of the steering committee for a group of farmers who supplied grain to the Puratone Group of Companies within two weeks of the filing of this CCAA proceeding. I will hereinafter refer to the group of farmers as "the ITB Claimants".

4 The Initial Order contained many of the usual provisions, including stay provisions as follows:

> **NO PROCEEDINGS AGAINST THE APPLICANTS OR THE PROPERTY**
>
> 18. THIS COURT ORDERS that until and including October 12, 2012, or such later date as this Court may order (the "Stay Period"), no proceeding or enforcement process in any court or tribunal (each, a "Proceeding") shall be commenced or continued against or in respect of the Applicants or the Monitor, or affecting the Business or the Property, except with the written consent of the Applicants and the Monitor, or with leave of this Court, and any and all Proceedings currently under way against or in respect of the Applicants or affecting the Business or the Property are hereby stayed and suspended pending further Order of this Court.
>
> **NO EXERCISE OF RIGHTS OR REMEDIES**
>
> 19. THIS COURT ORDERS that during the Stay Period, all rights and remedies of any individual, firm, corporation, governmental body or agency, or any other

entities (all of the foregoing, collectively being "**Persons**" and each being a "**Person**") against or in respect of the Applicants or the Monitor, or affecting the Business or the Property, are hereby stayed and suspended except with the written consent of the Applicants and the Monitor, or leave of this Court, provided that nothing in this Order shall (i) empower the Applicants to carry on any business which the Applicants are not lawfully entitled to carry on, (ii) affect such investigations, actions, suits or proceedings by a regulatory body as are permitted by Section 11.1 of the CCAA, (iii) prevent the filing of any registration to preserve or perfect a security interest, or (iv) prevent the registration of a claim for lien.

PROCEEDINGS AGAINST DIRECTORS AND OFFICERS

26. THIS COURT ORDERS that during the Stay Period, and except as permitted by subsection 11.03(2) of the CCAA, no Proceeding may be commenced or continued against any of the former, current or future directors or officers of the Applicants with respect to any claim against the directors or officers that arose before the date hereof and that relates to any obligations of the Applicants whereby the directors or officers are alleged under any law to be liable in their capacity as directors or officers for the payment or performance of such obligations, until a compromise or arrangement in respect of the Applicants, if one is filed, is sanctioned by this Court or is refused by the creditors of the Applicants or this Court.

5 Although the Initial Order included the stay provisions for only 30 days ending October 12, 2012, the stays have been extended as a result of a series of motions whilst Puratone has been undergoing its "restructuring". The restructuring referred to has essentially involved the sale of substantially all of its assets to Maple Leaf Foods Inc. on a going concern basis. That sale was approved by the court on November 8, 2012 and closed on December 17, 2012. As part of the order approving the sale, I ordered that the proceeds of sale should be paid to the Monitor to be held pending receipt of a Distribution Order. On March 12, 2013, I granted an order authorizing the distribution of most of the net proceeds from the sale of the assets. The creditors who received funds from the Distribution Order were as follows:

a) Bank of Montréal $17,726,173;

b) Farm Credit Corporation $15,817,303

c) Manitoba Agricultural Services Corporation (MASC) $ 1,041,524

6 The sworn pre-CCAA claim of Bank of Montréal before receiving this distribution was $43,322,558. The sworn pre-CCAA claim of the Farm Credit Corporation (FCC) before receiving this distribution was $41,025,891.76. The sworn pre-CCAA claim of MASC before receiving the distribution was $5,263,767.

7 There are therefore significant shortfalls being sustained by each of the major secured creditors.

8 The Monitor has retained a sum in an amount of $6,753,765 from the net proceeds. Of this amount, $1,573,765 has been withheld to deal with an issue that has arisen with the purchaser out of the sale and to that extent, as against Puratone and its creditors, the purchaser has the first claim against those funds. A further $5,000,000 was also recommended to be held back. These monies, in addition to whatever might be obtained from the relatively small number of assets yet to be liquidated, are intended to serve as a general holdback pending completion of the CCAA proceedings including the continued realization of remaining assets, resolution of the dispute with the purchaser and potential legal actions.

9 One of the potential legal actions is a claim by the ITB Claimants ("the ITB Claim"). At the time of the application of the Monitor for a Distribution Order, a motion was brought by the ITB Claimants requesting that $903,250.50 be withheld from any distribution to the major secured creditors, and requesting leave to commence an action against Puratone and its directors and/or officers in order to make the said claim. On its initial return date, I adjourned the motion of the ITB Claimants while authorizing the distribution set out above, which contemplated the holdback that had been recommended by the Monitor. I set time frames for the parties to provide briefs and any further affidavit material. On April 10, 2013 the ITB Claimants filed a further notice of motion which amplified their requests. The matter came on for hearing on April 11, 2013 at which time, after hearing submissions, I reserved judgment.

10 The claim of the ITB claimants is that they supplied grain to Puratone on an individual contract basis on various dates between August 29 and September 11, 2012, a period within two weeks of the filing of the CCAA proceeding. It is alleged that the grain was used by Puratone to feed the hogs that were ultimately sold to Maple Leaf Foods Inc. as part of the going concern sale ultimately approved by the court. The ITB Claimants argue that at the time of the supply transactions, Puratone was gearing up for its CCAA application and must have then known that it would have been unable to pay for the grain once an Initial Order was pronounced. In essence, the claim of the ITB Claimants boils down to allegations that Puratone acquired the grain when it had no intention of paying for it. As a result, the ITB claimants argue that they have causes of action against Puratone entitling them to:

a) damages for fraudulent misrepresentation on the part of Puratone;
b) a claim [an order] under s. 234 of ***The Corporations Act***, C.C.S.M. c. C225, that Puratone's conduct was oppressive as regards the plaintiffs;
c) a declaration that an implied or constructive trust exists in favour of the plaintiffs, and that Puratone and its secured creditors were unjustly enriched by the feed supplied by the plaintiffs;
d) a declaration that the secured creditors claims are subordinate to those of the plaintiffs, and/or that in equity they subordinated their security to the ITB Claimants;
e) a declaration that Puratone and its directors and officers wrongfully and/or fraudulently caused Puratone to obtain feed from the plaintiffs which they knew would not be paid for;
f) a declaration that the secured creditors colluded with Puratone and/or its directors and officers to, in effect, wrongfully obtain feed which they knew would not be paid for; and
g) a declaration that the secured creditors indemnified, in fact or at law, Puratone and/or its directors and officers by supporting and participating in a process that was designed to ensure that the secured creditors received the benefit of the feed without having to pay for it.

ANALYSIS

11 A stay of proceedings is normally included in an Initial Order in order to permit an applicant to proceed with its restructuring (including, in some cases, its liquidation) without continually being harassed by creditors who are dissatisfied with the state of their outstanding accounts. The theory behind the stay order is that it will allow the applicant to devote its full time, efforts and resources to presenting and executing a restructuring plan which is in the best interests of the creditors generally, rather than fighting rearguard actions against individual creditors who are trying to collect their individual accounts.

12 A stay of proceedings however can be lifted in the appropriate case, but those cases will be the subject of judicial consideration which normally involves a balancing of stakeholder interests.

13 The CCAA does not set out a specific test identifying the circumstances in which the stay of proceedings should be lifted. Rather, it is in the discretion of the supervising CCAA judge whether a proposed action should be allowed to proceed. Apart from giving the judge the authority to grant the stay, the only guidelines expressed in the CCAA respecting such a stay order are found in section 11.02(3) which says:

(3) 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.

14 In ***ICR Commercial Real Estate (Regina) Ltd. v. Bricore Land Group Ltd.***, 2007 SKCA 72, [2007] 9 W.W.R. 79, the Saskatchewan Court of the Appeal indicated that there must be "sound reasons", consistent with the scheme of the CCAA, to relieve against the stay. In the search for "sound reasons", the court suggested the following considerations:

a) the balance of convenience;
b) the relative prejudice to the parties; and
c) the merits of the proposed action.

It also indicated that, "The supervising *CCAA* judge should also consider the good faith and due diligence of the debtor company as referenced in s. 11(6)".

15 In my respectful view, these considerations are all to be viewed together and in the context of the nature and timing of the CCAA process before the court. The same request may very well receive a different reception in the case of an application for the lifting of a stay early in a CCAA proceeding that contemplates a true restructuring than in the case of an application brought late in a CCAA proceeding that involves only the sale of assets. In the former situation, the existence of a contemporaneous action might jeopardize the ability of the company to restructure as intended. In the latter case, the restructuring, such as it is, has been accomplished and the only issue being left to sort through is who is entitled to the money. In my view, a court would be more receptive to lifting the stay in the latter case than in the former.

The stay respecting claims against Puratone

16 The motion of the ITB Claimants was opposed by Bank of Montréal and FCC. They essentially argued that the ITB Claimants had not demonstrated the existence of a cause of action with enough of a reasonable prospect of success to justify a delay in the distribution of the holdback monies to the secured creditors. In short they focused on the third of the considerations described in ***ICR***. They argued that the proposed claim of the ITB Claimants for a constructive trust respecting some of the assets of Puratone would fail for a number of reasons, namely:

a) The sale of grain by the ITB Claimants involved transactions that do not qualify for the application of the doctrines of unjust enrichment, or equitable subordination. These transactions were essentially commercial transactions as between buyer and seller. It was argued that an unpaid seller is simply a debtor of Puratone. Although Puratone has received a

benefit, the normal buyer-seller relationship provides a juristic reason for the benefit, and therefore the doctrine of unjust enrichment does not apply. Furthermore the banks argued that the doctrine of equitable subordination has never been recognized in Canada.

b) The secured creditors are to be viewed as *bona fide* third parties with a commercial interest in the assets of Puratone and the ITB Claimants should not be entitled to jump the queue from the status of unsecured creditors and receive a priority ahead of secured creditors who hold valid and properly registered securities.

c) It is impossible to trace the grain into the hogs that were ultimately sold during the CCAA proceedings. Therefore, the ITB Claimants have no claim to the proceeds of sale of the hogs.

17 Counsel for the ITB Claimants has argued that this situation is a relatively new phenomenon. Historically, CCAA proceedings involved the restructuring of a company to permit it to carry on its business. CCAA proceedings in days gone by were not intended to be used where there were no future plans for the company. Counsel for the ITB Claimants argued that in this case, the plan was always to liquidate the assets in a controlled way in order to maximize the return to the secured creditors, but with the expectation that a shortfall would invariably occur to the secured creditors. He submitted that it must have been well known to Puratone as well as its secured creditors and directors and officers that at the time that the grain was supplied by the ITB claimants, Puratone was deeply underwater to its secured creditors. He argued that the evidence of knowledge of such insolvent condition can be inferred by the large shortfall suffered by Bank of Montréal and FCC notwithstanding a going concern sale which was negotiated during the CCAA proceedings only two months after the feed was supplied by the ITB Claimants. Counsel submits that CCAA applications of the scale of this proceeding are not prepared overnight, and that at the time of the supply of grain, Puratone would have been preparing its CCAA materials and would have known that the CCAA proceedings would only yield a sale which resulted in large secured creditor deficiencies. He argued that at the time of these contracts of supply, there was no likelihood that the ITB claimants would receive any of their money. He argued that by ordering the grain under these circumstances, essentially Puratone was perpetrating a fraud on the ITB claimants.

18 It was urged upon me by counsel for the two banks that the case authorities require a judge to scrutinize the claim which a creditor intends to advance before lifting the stay in a CCAA proceeding. It was argued that the authorities suggest that the test to be employed in lifting a CCAA stay is more than the test used in striking out a statement of claim as disclosing no cause of action or being frivolous and vexatious, but does not require prospective plaintiffs to demonstrate a *prima facie* case. The terms "reasonable cause of action" or "tenable case" have sometimes been used.

19 In the ***ICR*** case, at paragraph 64 and 65, Jackson, JA wrote:

> [64] Koch J. used *prima facie* case, which he equated with tenable cause of

> action. "Tenable cause of action" is taken from Ground J.'s decision in *Ivaco*, but Ground J. used "reasonable cause of action" or "tenable case," as comparable terms and as only one of four criteria to be considered. The use of "*prima facie* case" defined as "tenable cause of action" is not particularly helpful as the words have been used in different contexts with different purposes in mind. Even in the context of bankruptcy where specific guidelines are given, and the courts have had long experience with the application of the tests, the debate continues as to what is meant by *prima facie* case and whether it is too high of a standard to apply in determining whether an action may be commenced.
>
> [65] Koch J. was clearly correct to hold that the threshold established by s. 173 of *The Queen's Bench Rules* is too low. On the other hand, it is also important not to decide the case. The purpose for passing on the claim is not to determine whether it will or will not succeed, but to determine whether the plan of arrangement should be delayed or further compromised to accommodate a future claim, or some other step need be taken to maintain the integrity of the *CCAA* proceeding.
>
> (Emphasis added)

20 When I scrutinize the proposed claim of the ITB Claimants against Puratone, I conclude that its dismissal is not a foregone conclusion. The ITB Claimants raise a point which so far as I am aware has not been addressed by this court. Here, the court is faced with a CCAA proceeding which has had from the outset all of the earmarks of a liquidation proceeding. The affidavit of Raymond Hildebrand, sworn September 12, 2012 underlying the request for the Initial Order as well as the Pre-Filing Monitor's Report outlined the financial difficulties being experienced by Puratone, the reasons for those difficulties, as well as the efforts that had been made by Puratone and its restructuring professionals to deal with them. Some of the efforts had included a Sales and Solicitation Process ("SISP"), a process designed to find people who were willing to inject money into Puratone either through a going concern sale of assets or in equity injection. Those efforts failed.

21 In the Pre-Filing Report of Deloitte & Touche Inc., the then Proposed Monitor wrote:

> 46 The Proposed Monitor has been advised that the SISP, as originally proposed, failed to result in a successful investment or sale transaction. Accordingly, the SISP has been terminated and replaced with a short-term, expedited strategy to complete a sale of the business, or parts thereof, which will be undertaken by the Applicants with the assistance of the Proposed Monitor (the "Sales Process").

22 The Initial Order was granted based on information, *inter alia,* that the major secured creditors were Bank of Montréal and FCC. As indicated earlier, less than three months later, the parties were

recommending a sale which would result in large secured creditor shortfalls. The ITB Claimants argue that this result must have been contemplated by Puratone at the time that the ITB Claimants supplied their grain to Puratone. This raises the interesting question as to whether that expectation was in the mind of Puratone at the time that the grain was supplied, and if so, whether the ITB Claimants are entitled to any relief from Puratone other than a meaningless monetary judgment. It raises the issue whether a company with exposed secured creditors should be incurring credit at a time when it is preparing to make a CCAA application.

23 The ITB claimants request a constructive trust over the assets of Puratone that were sold during the CCAA proceeding which, if ordered, would erode the assets over which the banks claim security by the amount of the unpaid accounts of the ITB Claimants. A constructive trust has been recognized as a remedy against a debtor in the event that there has been a fraud. In Peter D. Maddaugh and John D. McCamus, The Law of Restitution, (looseleaf), Volume 1, at paragraph 5:200.30, the following is written:

> Chancery's willingness to impose a constructive trust in circumstances where a fraud has been perpetrated is by no means a modern development. No pre-existing fiduciary relationship need be established for this category of constructive trust and, indeed, a breach of trust or other fiduciary obligation is, in itself, simply one form of equitable fraud. As Lord Westbury explained in McCormick v. Grogan, L.R. 4 H.L. 82: "it is a jurisdiction by which a Court of Equity, proceeding on the ground of fraud, converts the party who has committed it into a trustee for the party who is injured by that fraud." And, in Westdeutsche Landesbank Girozentrale v. Islington L.B.C., [1994] 4 All E.R. 890, Lord Browne-Wilkinson recognized that "when property is obtained by fraud equity imposes a constructive trust on the fraudulent recipient: the property is recoverable and traceable in equity". For example, one who acquires property by theft or fraudulent misrepresentation may be held a constructive trustee of the misappropriated property.

24 The question arises whether there is any practical reason for permitting the ITB Claimants to make their claim against Puratone at this time. Courts will generally not impose a constructive trust where the remedy jeopardizes the priority of innocent parties for value. In this regard, see ***Lac MineralsLtd. v. International Corona Resources Ltd***., [1989] 2 S.C.R. 574, where LaForest J says:

> 197 ...In the vast majority of cases a constructive trust will not be the appropriate remedy. Thus, in Hunter Engineering Co. v. Syncrude Canada Ltd., [1989] 1 S.C.R. 426, supra, had the restitutionary claim been made out, there would have been no reason to award a constructive trust, as the plaintiff's claim could have been satisfied simply by a personal monetary award; a constructive trust should only be awarded if there is reason to grant to the plaintiff the additional rights that flow from recognition of a right of property. Among the most important of

> these will be that it is appropriate that the plaintiff receive the priority accorded to the holder of a right of property in a bankruptcy....

The banks argue that there is no evidence that they are anything but innocent parties in these circumstances. Counsel for the two banks argue that there is no affidavit evidence adduced by the ITB Claimants that indicates that the banks were knowledgeable about any fraudulent intent on the part of Puratone, even if such existed. They argue that the court should not lift the stay simply on the basis that the ITB Claimants make such an unsubstantiated allegation. Rather it is argued that the banks should, for the purpose of this motion, be assumed to have had no knowledge of any bad intent that is alleged to have been possessed on the part of Puratone, and that being the case, there is no prospect, let alone a reasonable prospect, that the ITB Claimants will be successful in obtaining a constructive trust at the end of the day.

25 The problem which I see with this submission is that evidence of the knowledge of the banks at the material times is a factual matter that is not readily apparent. Evidence such as that would normally only surface during the discovery process in civil litigation. The banks have chosen to file no affidavit material in this motion. It seems too high a threshold to require the ITB Claimants to demonstrate the knowledge of the banks at the material times on this motion. For current purposes, it is sufficient to conclude that given the size of the troubled loans, a reasonable inference is that the two banks who appeared to oppose the ITB Claimants motion would have been aware of the pending CCAA proceedings before they were filed, and at the time that the grain was being supplied, bank representatives would have had more than a cursory understanding of the business of Puratone and its financial difficulties. Whether the banks were aware that Puratone was purchasing grain on other than a COD basis after the decision had been made to apply for a CCAA order, and if so, whether the banks were in any position to do anything about it, is currently unknown. I do not say that the ITB Claimants will prevail in demonstrating the necessary knowledge in the fullness of time, but they have a claim which raises interesting issues, and they should be given the opportunity to pursue it sooner rather than later, especially when the existence of the claim will not jeopardize any restructuring.

26 What then of the other considerations enumerated by Jackson JA in the ***ICR*** case?

27 The merits of the claim against Puratone aside for the moment, the ITB Claim essentially translates into a priority claim between competing creditors. There is no restructuring plan which is being put at risk in this case. This proceeding is almost over. There are a few assets left to be liquidated, but that process will not be put at risk by the existence of the proposed claim by the ITB Claimants. Indeed, the Monitor confirms as such when in its latest report, it observed:

> 20. The Monitor understands that the general purpose of a stay of proceedings under the CCAA is to maintain the *status quo* for a period of time in order that a debtor company (and its directors and officers) can focus on restructuring efforts without undue interference.

> 21. Substantially all of the undertaking, property and assets of the Applicants have been sold and it is not anticipated that any formal restructuring will occur. In these circumstances, subject to the proviso which follows with respect to the role of the Monitor should litigation ensue, the Monitor is of the view that there would be no particular prejudice to the CCAA Proceedings if the stay of proceedings is lifted to enable ITB to initiate and proceed with an action against the Applicants and the directors and/or officers of the Applicants.

28 The proviso of the Monitor was simply that it not be required to retain any role in the litigation, if it was allowed to proceed.

29 Accordingly, the balance of convenience favours the ITB Claimants.

30 What then is the prejudice to be suffered if the claim were permitted to proceed at this time? The real prejudice in this case is that if the ITB Claimants are entitled to commence their action now against Puratone and the secured creditors, there could be a delay in the distribution of the holdback monies to the secured creditors. The banks would essentially be deprived of their use of the monies during the litigation and the return on the monies while sitting in the Monitor's trust account would not match what the banks might earn on those monies were they in hand.

31 On the other hand, if I do not permit the claim to be made at this time, the ITB Claimants would be forced to await the end of the CCAA proceeding before commencing their claim. By that time, there would be no money left in Puratone. It all will have been paid to the secured creditors, with at least the tacit acknowledgment by the court that those creditors were entitled to those monies ahead of anyone else. A result such as this is inconsistent with the notion that in a CCAA proceeding, creditors have resort to the supervising court to adjudicate on priority disputes.

32 Any prejudice created by the delay in distribution of funds can easily be alleviated by analogy to the Court Rules respecting prejudgment garnishment. In effect, that is the result which is being sought by the ITB Claimants. Although *Queen's Bench Rule* 46.14 (1) permits garnishment before judgment, Rule 46.14 (3) reads as follows:

> 46.14(3) An order under subrule (1) (Form 46D) may include,
>
> (a) a requirement that the plaintiff post security in a form and amount to be determined by the court; and
> (b) such other terms and conditions as may be just.

33 There is no doubt that the secured creditors are *prima facie* entitled to the proceeds of these proceedings. They have valid security agreements which have been properly registered. The ITB Claimants seek to challenge their priority not on the basis that the banks are not secured creditors, but on the basis of factual circumstances that would make it equitable to provide the ITB Claimants

with a priority over the secured creditors. There are factual impediments to their claim for unjust enrichment and potentially legal impediments to their claim for equitable subordination and tracing. If I give them the right to make those claims, and those claims are not successful, the delays which those claims might cause to the timely receipt of monies by the secured creditors should not go unaddressed. This can be done by requiring the ITB Claimants to each file an undertaking whereby they would be liable to pay either or both of the banks damages arising from the delay in the payment of the holdback monies attributable to their claim. I am therefore ordering that out of the general holdback monies the amount of $903,250.50 be dedicated to the ITB Claim and not be paid out without further order of court, which presumably will occur either after the claim has been resolved or upon sufficient evidence being demonstrated that it has not been prosecuted in a timely way. Counsel may try and agree on the form of the undertaking as to damages, but may come back to me should agreement not be reached.

34 As regards Puratone, I therefore make the following orders:

a) Out of the general holdback monies, the sum of $903,250.50 and any interest accrued thereon since March 12, 2013 shall be segregated in an interest bearing account designated as the ITB Claim Monies.

b) Leave is given to the ITB Claimants to commence the action against Puratone described at Schedule A of their notice of motion dated April 10, 2013, provided:

(1) they issue it within 40 days after the date of signing of the Order that evidences this decision, and

(2) Prior to the issuance of the Statement of Claim, each named plaintiff will file an undertaking as to damages for its pro rata share of any damages sustained by Bank of Montréal and/or FCC arising from any delay after July 31, 2013 in the distribution of its portion of the ITB Claim monies to Bank of Montréal and/or FCC caused by the issuance of the ITB Claim.

35 If a claimant does not file the requested undertaking as to damages, I will consider that such claimant has abandoned its claim and the ITB Claim Monies may be reduced by the amount of that claimant's claim.

The Proposed Claim against the directors and/or officers

36 The claim of the ITB Claimants against the directors and/or officers similarly finds its roots in the allegations of fraud made against Puratone. Counsel for the directors and officers relies upon the case of ***Peoples Department Stores Inc. (Trustee Of) v. Wise***, 2004 SCC 68, [2004] S.C.J. No. 64, drawing from it the principle that deference ought to be given to the decisions that directors make as they fulfil their functions. Notwithstanding that case, there is an argument to be made that where a

company has committed a fraud, be it legal or equitable, knowledge on the part of directors of such conduct by officers or employees of the company may make the directors vicariously and/or personally liable.

37 Again, evidence of the actual knowledge of the directors and/or the officers is not readily apparent without the ability to inquire into the records of the company through the discovery process. For the same reasons that I expressed as regards the two banks, requiring the ITB Claimants to adduce evidence on this motion of the directors' and officers' knowledge is too high a threshold to impose. A reasonable inference is that at least some of the directors and officers would have known that a CCAA proceeding was being prepared within the two week period prior to the CCAA filing, and at least some of the directors and officers would have had intimate knowledge of the financial constraints of the company and the efforts which the company was employing to solve them during the two week period prior to the filing of the CCAA proceeding. That reasonable inference in my view is sufficient to conclude that the proposed claim against the directors and/or officers is not necessarily doomed to fail. This case, as with many, will depend on facts not currently available to the court.

38 Additionally, the balance of convenience favours the ITB Claimants, and I see no prejudice to the directors and officers facing the ITB claim sooner rather than later.

39 In my view there are sound reasons to justify lifting the stay to permit the ITB Claimants to issue the proposed claim against the officers and are directors, providing it is issued within 40 days after the date of signing of the Order that evidences this decision. It will however be necessary for the claimants to name the particular individuals who they propose to sue, recognizing that they may expose themselves to costs, possibly on a solicitor and own client basis, for every person that they unsuccessfully sue.

GOING FORWARD

40 I have contemplated that the claim should be commenced by one statement of claim, naming at least Puratone and the named officers and directors. The normal Rules of the Court should be followed with the additional requirement that the action will be case managed. A case management conference before me shall be set up within 30 days of the close of pleadings, or earlier upon written request of any party.

41 If necessary, the costs of this motion shall be determined by me upon the resolution of the ITB Claims.

R.A. DEWAR J.

TAB 10

Case Name:

Timminco Ltd. (Re)

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 Timminco Limited and Bécancour Silicon Inc., Applicants

[2012] O.J. No. 1949

2012 ONSC 2515

Court File Nos. CV-12-9539-00CL and CV-09-378701-00CP

Ontario Superior Court of Justice
Commercial List

G.B. Morawetz J.

Heard: March 26, 2012.
Judgment: April 27, 2012.

(25 paras.)

Bankruptcy and insolvency law -- Companies' Creditors Arrangement Act (CCAA) matters -- Motion by plaintiff in class proceeding/creditor of company under CCAA protection to lift stay of proceedings allowed in part -- Stay lifted only to permit plaintiff to seek leave to appeal to Supreme Court of Canada procedural judgment about running of limitations period for class proceeding -- TO lift stay entirely would take focus of company's few remaining executives away from restructuring to deal with class proceeding, potentially causing prejudice to other stakeholders.

Bankruptcy and insolvency law -- Proceedings -- Practice and procedure -- Stays -- Motion by plaintiff in class proceeding/ creditor of company under CCAA protection to lift stay of proceedings allowed in part -- Stay lifted only to permit plaintiff to seek leave to appeal to Supreme Court of Canada procedural judgment about running of limitations period for class proceeding -- TO lift stay entirely would take focus of company's few remaining executives away from restructuring to deal with class proceeding, potentially causing prejudice to other stakeholders.

Civil litigation -- Civil procedure -- Parties -- Class or representative actions -- Procedure --

Motion by plaintiff in class proceeding/creditor of company under CCAA protection to lift stay of proceedings allowed in part -- Stay lifted only to permit plaintiff to seek leave to appeal to Supreme Court of Canada procedural judgment about running of limitations period for class proceeding -- TO lift stay entirely would take focus of company's few remaining executives away from restructuring to deal with class proceeding, potentially causing prejudice to other stakeholders.

Motion by Penneyfeather for an order lifting a January 2012 stay of proceedings to permit Penneyfeather to continue a class proceeding against Timminco and others. Timminco was pursuing a restructuring process intended to maximize recovery for stakeholders. It continued to operate as a going concern with a greatly-reduced staff of 10 employees including the president and three executive officers. The class proceeding was commenced in May 2009. Settlement discussions had been terminated and there was a pending motion to strike portions of the statement of claim. Penneyfeather planned to seek leave to appeal to the Supreme Court of Canada an order declaring that the three-year limitation period provided in the Securities Act was not suspended by the operation of the Class Proceedings Act. Timminco consented to lift the stay to permit Penneyfeather to pursue this leave application only. Timminco submitted that key members of its executive team would have to expend considerable time dealing with Penneyfeather's class proceeding if the stay was lifted completely, thereby taking their focus away from the restructuring process.

HELD: Motion allowed in part. If forced to spend significant amounts of time dealing with Penneyfeather's class action in the coming months, the Timminco executive team would be unable to focus on the sales and restructuring process to the potential detriment of Timminco's other stakeholders. A delay in the sales process could have a negative impact on Timminco. It was premature to lift the stay other than with respect to the leave application.

Statutes, Regulations and Rules Cited:

Class Proceedings Act, S.O. 1992, c. 6, s. 12, s. 28

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

Securities Act, R.S.O. 1990, c. S.5, s. 138.14

Counsel:

James C. Orr and N. Mizobuchi, for St. Clair Penneyfeather, Plaintiff in Class Proceeding, *Penneyfeather v. Timminco Limited et al*.

P. O'Kelly and A. Taylor, for the Applicants.

P. LeVay, for the Photon Defendants.

A. Lockhart, for Wacker Chemie AG.

K.D. Kraft, for Chubb Insurance Company of Canada.

D.J. Bell, for John P. Walsh.

A. Hatnay and James Harnum for Mercer Canada, Administrator of the Timminco Haley Plan.

S. Weisz, for FTI Consulting Canada Inc., Monitor.

ENDORSEMENT

1 **G.B. MORAWETZ J.**:-- St. Clair Penneyfeather, the Plaintiff in the *Penneyfeather v. Timminco Limited, et al* action, Court File No. CV-09-378701-00CP (the "Class Action"), brought this motion for an order lifting the stay of proceedings, as provided by the Initial Order of January 3, 2012 and extended by court order dated January 27, 2012, and permitting Mr. Penneyfeather to continue the Class Action against Timminco Limited ("Timminco"), Dr. Heinz Schimmelbusch, Mr. Robert Dietrich, Mr. Rene Boisvert, Mr. Arthur R. Spector, Mr. Jack Messman, Mr. John C. Fox, Mr. Michael D. Winfield, Mr. Mickey M. Yaksich and Mr. John P. Walsh.

2 The Class Action was commenced on May 14, 2009 and has been case managed by Perell J. The following steps have taken place in the litigation:

(a) a carriage motion;
(b) a motion to substitute the Representative Plaintiff;
(c) a motion to force disclosure of insurance policies;
(d) a motion for leave to appeal the result of the insurance motion which was heard by the Divisional Court and dismissed;
(e) settlement discussions;
(f) when settlement discussions were terminated, Perell J. declined an expedited leave hearing and instead declared any limitation period to be stayed;
(g) a motion for particulars; and
(h) a motion served but not heard to strike portions of the Statement of Claim.

3 On February 16, 2012, the Court of Appeal for Ontario set aside the decision of Perell J. declaring that s. 28 of the *Class Proceedings Act* suspended the running of the three-year limitation period under s. 138.14 of the *Securities Act*.

4 The Plaintiffs' counsel received instructions to seek leave to appeal the decision of the Court of Appeal for Ontario to the Supreme Court of Canada. The leave materials were required to be served and filed by April 16, 2012.

5 On April 10, 2012, the following endorsement was released in respect of this motion:

> The portion of the motion dealing with lifting the stay for the Plaintiff to seek leave to appeal the recent decision of the Court of Appeal for Ontario to the Supreme Court of Canada on the limitation period issue was not opposed. This portion of the motion is granted and an order shall issue to give effect to the foregoing. The balance of the requested relief is under reserve.

6 Counsel to Mr. Penneyfeather submits that, apart from the leave to appeal issues, there are steps that may occur before Perell J. as a result of the Court of Appeal ruling. Counsel references that the Defendants may bring motions for partial judgment and the Plaintiff could seek to have the court proceed with leave and certification with any order to be granted *nunc pro tunc* pursuant to s. 12 of the *Class Proceedings Act*.

7 Counsel to Mr. Penneyfeather submits that the three principal objectives of the *Class Proceedings Act* are judicial economy, access to justice and behaviour modification. (See *Western Canadian Shopping Centres Inc. v. Dutton*, [2001] 2 S.C.R. 534 at paras. 27-29.), and under the *Securities Act*, the deterrent represented by private plaintiffs armed with a realistic remedy is important in ensuring compliance with continuous disclosure rules.

8 Counsel submits that, in this situation, there is only one result that will not do violence to a primary legislative purpose and that is to lift the stay to permit the Class Action to proceed on the condition that any potential execution excludes Timminco's assets. Counsel further submits that, as a practical result, this would limit recovery in the Class Action to the proceeds of the insurance policies, or in the event that the insurers decline coverage because of fraud, to the personal assets of those officers and directors found responsible for the fraud.

9 Counsel to Mr. Penneyfeather takes the position that the requested outcome is consistent with the judicial principal that the CCAA is not meant as a refuge insulating insurers from providing appropriate indemnification. (See *Algoma Steel Corp. v. Royal Bank of Canada*, [1992] O.J. No. 889 at paras. 13-15 (C.A.) and *Re Carey Canada Inc*. [2006] O.J. No. 4905 at paras. 7, 16-17.)

10 In this case, counsel contends that, when examining the relative prejudice to the parties, the examination strongly favours lifting the stay in the manner proposed since the insurance proceeds are not available to other creditors and there would be no financial unfairness caused by lifting the stay.

11 The position put forward by Mr. Penneyfeather must be considered in the context of the CCAA proceedings. As stated in the affidavit of Ms. Konyukhova, the stay of proceedings was put in place in order to allow Timminco and Bécancour Silicon Inc. ("BSI" and, together with Timminco, the "Timminco Entities") to pursue a restructuring and sales process that is intended to maximize recovery for the stakeholders. The Timminco Entities continue to operate as a going concern, but with a substantially reduced management team. The Timminco Entities currently have

only ten active employees, including Mr. Kalins, President, General Counsel and Corporate Secretary and three executive officers (the "Executive Team").

12 Counsel to the Timminco Entities submits that, if Mr. Penneyfeather is permitted to pursue further steps in the Class Action, key members of the Executive Team will be required to spend significant amounts of their time dealing with the Class Action in the coming months, which they contend is a key time in the CCAA proceedings. Counsel contends that the executive team is currently focussing on the CCAA proceedings and the sales process.

13 Counsel to the Timminco Entities points out that the Executive Team has been required to direct most of their time to restructuring efforts and the sales process. Currently, the "stalking horse" sales process will continue into June 2012 and I am satisfied that it will require intensive time commitments from management of the Timminco Entities.

14 It is reasonable to assume that, by late June 2012, all parties will have a much better idea as to when the sales process will be complete.

15 The stay of proceedings is one of the main tools available to achieve the purpose of the CCAA. The stay provides the Timminco Entities with a degree of time in which to attempt to arrange an acceptable restructuring plan or sale of assets in order to maximize recovery for stakeholders. The court's jurisdiction in granting a stay extends to both preserving the *status quo* and facilitating a restructuring. See *Re Stelco Inc*., [2005] O.J. No. 1171 (C.A.) at para. 36.

16 Further, the party seeking to lift a stay bears a heavy onus as the practical effect of lifting a stay is to create a scenario where one stakeholder is placed in a better position than other stakeholders, rather than treating stakeholders equally in accordance with their priorities. See *Canwest Global Communications Corp. (Re)*, [2011] O.J. No. 1590 (S.C.J.) at para. 27.

17 Courts will consider a number of factors in assessing whether it is appropriate to lift a stay, but those factors can generally be grouped under three headings: (a) the relative prejudice to parties; (b) the balance of convenience; and (c) where relevant, the merits (*i.e.* if the matter has little chance of success, there may not be sound reasons for lifting the stay). See *Canwest Global Communications (Re), supra*, at para. 27.

18 Counsel to the Timminco Entities submits that the relative prejudice to the parties and the balance of convenience clearly favours keeping the stay in place, rather than to allow the Plaintiff to proceed with the SCC leave application. As noted above, leave has been granted to allow the Plaintiff to proceed with the SCC leave application. Counsel to the Timminco Entities further submits that, while the merits are vigorously disputed by the Defendants in the context of a Class Action, the Timminco Entities will not ask this court to make any determinations based on the merits of the Plaintiff's claim.

19 I can well recognize why Mr. Penneyfeather wishes to proceed. The objective of the Plaintiff

in the Class Action is to access insurance proceeds that are not available to other creditors. However, the reality of the situation is that the operating side of Timminco is but a shadow of its former self. I accept the argument put forth by counsel to the Applicant that, if the Executive Team is required to spend significant amounts of time dealing with the Class Action in the coming months, it will detract from the ability of the Executive Team to focus on the sales process in the CCAA proceeding to the potential detriment of the Timminco Entities' other stakeholders. These are two competing interests. It seems to me, however, that the primary focus has to be on the sales process at this time. It is important that the Executive Team devote its energy to ensuring that the sales process is conducted in accordance with the timeliness previously approved. A delay in the sales process may very well have a negative impact on the creditors of Timminco. Conversely, the time sensitivity of the Class Action has been, to a large extent, alleviated by the lifting of the stay so as to permit the leave application to the Supreme Court of Canada.

20 It is also significant to recognize the submission of counsel on behalf of Mr. Walsh. Counsel to Mr. Walsh takes the position that Mr. Penneyfeather has nothing more than an "equity claim" as defined in the CCAA and, as such, his claim (both against the company and its directors who, in turn, would have an equity claim based on indemnity rights) would be subordinated to any creditor claims. Counsel further submits that of all the potential claims to require adjudication, presumably, equity claims would be the least pressing to be adjudicated and do not become relevant until all secured and unsecured claims have been paid in full.

21 In my view, it is not necessary for me to comment on this submission, other than to observe that to the extent that the claim of Mr. Penneyfeather is intended to access certain insurance proceeds, it seems to me that the prosecution of such claim can be put on hold, for a period of time, so as to permit the Executive Team to concentrate on the sales process.

22 Having considered the relative prejudice to the parties and the balance of convenience, I have concluded that it is premature to lift the stay at this time, with respect to the Timminco Entities, other than with respect to the leave application to the Supreme Court of Canada. It also follows, in my view, that the stay should be left in place with respect to the claim as against the directors and officers. Certain members of this group are involved in the Executive Team and, for the reasons stated above, I am satisfied that it is not appropriate to lift the stay as against them.

23 With respect to the claim against Photon, as pointed out by their counsel, it makes no sense to lift the stay only as against Photon and leave it in place with respect to the Timminco Entities. As counsel submits, the Timminco Entities have an interest in both the legal issues and the factual issues that may be advanced if Mr. Penneyfeather proceeds as against Photon, as any such issues as are determined in Timminco's absence may cause unfairness to Timminco, particularly, if Mr. Penneyfeather later seeks to rely on those findings as against Timminco. I am in agreement with counsel's submission that to make such an order would be prejudicial to Timminco's business and property. In addition, I accept the submission that it would also be unfair to Photon to require it to answer Mr. Penneyfeather's allegations in the absence of Timminco as counsel has indicated that

Photon will necessarily rely on documents and information produced by Timminco as part of its own defence.

24 I am also in agreement with the submission that it would be wasteful of judicial resources to permit the class proceedings to proceed as against Photon but not Timminco as, in addition to the duplicative use of court time, there would be the possibility of inconsistent findings on similar or identical factual issues and legal issues. For these reasons, I have concluded that it is not appropriate to lift the stay as against Photon.

25 In the result, the motion dealing with issues not covered by the April 10, 2012 endorsement is dismissed without prejudice to the rights of the Plaintiff to renew his request no sooner than 75 days after today's date.

G.B. MORAWETZ J.

TAB 11

Case Name:

Canwest Global Communications Corp. (Re)

IN THE MATTER OF the Companies' Creditors Arrangement Act, R.S.C. 1985, C-36, as amended
AND IN THE MATTER OF a proposed plan of compromise or arrangement of Canwest Global Communications Corp. and the other applicants listed on Schedule "A"

[2009] O.J. No. 5379

61 C.B.R. (5th) 200

2009 CarswellOnt 7882

183 A.C.W.S. (3d) 634

2009 CanLII 70508

Court File No. CV-09-8241-OOCL

Ontario Superior Court of Justice
Commercial List

S.E. Pepall J.

Heard: December 8, 2009.
Judgment: December 15, 2009.

(52 paras.)

Bankruptcy and insolvency law -- Companies' Creditors Arrangement Act (CCAA) matters -- Compromises and arrangements -- Claims -- Application in this Companies' Creditors Arrangement Act matter for an order declaring that the relief sought by the "GS Parties" was subject to an Oct. 6, 2009 stay of proceedings granted -- Cross-motion by the GS Parties for an order lifting the stay so that they could pursue their motion challenging pre-filing conduct of the CMI entities, etc., dismissed -- The substance and subject matter of the motion were certainly encompassed by the stay -- The balance of convenience, the assessment of relative prejudice and the relevant merits favoured the position of the CMI Entities on the lift stay motion.

Bankruptcy and insolvency law -- Proceedings -- Practice and procedure -- Stays -- Application in this Companies' Creditors Arrangement Act matter for an order declaring that the relief sought by the "GS Parties" was subject to an Oct. 6, 2009 stay of proceedings granted -- Cross-motion by the GS Parties for an order lifting the stay so that they could pursue their motion challenging pre-filing conduct of the CMI entities, etc., dismissed -- The substance and subject matter of the motion were certainly encompassed by the stay -- The balance of convenience, the assessment of relative prejudice and the relevant merits favoured the position of the CMI Entities on the lift stay motion.

Application by the CCAA applicants and the "CMI entities" for an order declaring that the relief sought by the "GS parties" was subject to the stay of proceedings granted on Oct. 6, 2009. Cross-motion by GS Parties for an order lifting the stay so they could pursue their motion challenging pre-filing conduct of the CMI entities, etc. The Ad Hoc Committee of Noteholders and the Special Committee of the Board of Directors supported the position of the CMI Entities. In essence, the GS Parties' motion sought to undo the transfer of the CW Investments Co. shares from 441 to CMI or to require CMI to perform and not disclaim the shareholders agreement as though the shares had not been transferred.

HELD: GS Parties' motions dismissed, save for a portion dealing with para. 59 of the initial order on consent; CMI Entities' motion granted with the exception of a strike portion, which was moot. The first issue was caught by the stay of proceedings and the second was properly addressed if and when CMI sought to disclaim the shareholders agreement. The substance of the GS Parties' motion was a "proceeding" subject to the stay under para. 15 of the initial order prohibiting the commencement of all proceedings against or in respect of the CMI Entitites, or affecting the CMI business or property. The relief sought would also involve "the exercise of any right or remedy affecting the CMI business or the CMI property" which was stayed under para. 16 of the initial order. The substance and subject matter of the motion were certainly encompassed by the stay. The real question was whether the stay ought to be lifted in this case. If the stay were lifted, the prejudice to CMI would be great and the proceedings contemp lated by the GS Parties would be extraordinarily disruptive. The GS Parties were in no worse position than any other stakeholder who was precluded from relying on rights that arise upon an insolvency default. The balance of convenience, the assessment of relative prejudice and the relevant merits favoured the position of the CMI Entities on the lift stay motion. The onus to lift the stay was on the moving party. The stay was performing the essential function of keeping stakeholders at bay in order to give CMI Entities a reasonable opportunity to develop a restructuring plan.

Statutes, Regulations and Rules Cited:

Companies' Creditors Arrangement Act, R.S.C. 1985, c. C-36, s. 32, s. 11.02

Counsel:

Lyndon Barnes, Alex Cobb and Shawn Irving for the CMI Entities.

Alan Mark and Alan Merskey for the Special Committee of the Board of Directors of Canwest.

David Byers and Maria Konyukhova for the Monitor, FTI Consulting Canada Inc.

Benjamin Zarnett and Robert Chadwick for the Ad Hoc Committee of Noteholders.

K. McElcheran and G. Gray for GS Parties.

Hugh O'Reilly and Amanda Darrach for Canwest Retirees and the Canadian Media Guild.

Hilary Clarke for Senior Secured Lenders to LP Entities.

Steve Weisz for CIT Business Credit Canada Inc.

REASONS FOR DECISION

S.E. PEPALL J.:--

Relief Requested

1 The CCAA applicants and partnerships (the "CMI Entities") request an order declaring that the relief sought by GS Capital Partners VI Fund L.P., GSCP VI AA One Holding S.ar.1 and GS VI AA One Parallel Holding S.ar.1 (the "GS Parties") is subject to the stay of proceedings granted in my Initial Order dated October 6, 2009. The GS Parties bring a cross-motion for an order that the stay be lifted so that they may pursue their motion which, among other things, challenges pre-filing conduct of the CMI Entities. The Ad Hoc Committee of Noteholders and the Special Committee of the Board of Directors support the position of the CMI Entities. All of these stakeholders are highly sophisticated. Put differently, no one is a commercial novice. Such is the context of this dispute.

Background Facts

2 Canwest's television broadcast business consists of the CTLP TV business which is comprised of 12 free-to-air television stations and a portfolio of subscription based specialty television channels on the one hand and the Specialty TV Business on the other. The latter consists of 13 specialty television channels that are operated by CMI for the account of CW Investments Co. and its subsidiaries and 4 other specialty television channels in which the CW Investments Co. ownership interest is less than 50%.

3 The Specialty TV Business was acquired jointly with Goldman Sachs from Alliance Atlantis in August, 2007. In January of that year, CMI and Goldman Sachs agreed to acquire the business of

Alliance Atlantis through a jointly owned acquisition company which later became CW Investments Co. It is a Nova Scotia Unlimited Liability Corporation ("NSULC").

4 CMI held its shares in CW Investments Co. through its wholly owned subsidiary, 4414616 Canada Inc. ("441"). According to the CMI Entities, the sole purpose of 441 was to insulate CMI from any liabilities of CW Investments Co. As a NSULC, its shareholders may face exposure if the NSULC is liquidated or becomes bankrupt. As such, 441 served as a "blocker" to potential liability. The CMI Entities state that similarly the GS parties served as "blockers" for Goldman Sachs' part of the transaction.

5 According to the GS Parties, the essential elements of the deal were as follows:

(i) GS would acquire at its own expense and at its own risk, the slower growth businesses;
(ii) CW Investments Co. would acquire the Specialty TV Business and that company would be owned by 441 and the GS Parties under the terms of a Shareholders Agreement;
(iii) GS would assist CW Investments Co. in obtaining separate financing for the Specialty TV Business;
(iv) Eventually Canwest would contribute its conventional TV business on a debt free basis to CW Investments Co. in return for an increased ownership stake in CW Investments Co.

6 The GS Parties also state that but for this arrangement, Canwest had no chance of acquiring control of the Specialty TV Business. That business is subject to regulation by the CRTC. Consistent with policy objectives, the CRTC had to satisfy itself that CW Investments Co. was not controlled either at law or in fact by a non-Canadian.

7 A Shareholders Agreement was entered into by the GS parties, CMI, 441, and CW Investments Co. The GS Parties state that 441 was a critical party to this Agreement. The Agreement reflects the share ownership of each of the parties to it: 64.67% held by the GS Parties and 35.33% held by 441. It also provides for control of CW Investments Co. by distribution of voting shares: 33.33% held by the GS Parties and 66.67% held by 441. The Agreement limits certain activities of CW Investments Co. without the affirmative vote of a director nominated to its Board by the GS Parties. The Agreement provides for call and put options that are designed to allow the GS parties to exit from the investment in CW Investments Co. in 2011, 2012, and 2013. Furthermore, in the event of an insolvency of CMI, the GS parties have the ability to effect a sale of their interest in CW Investments Co. and require as well a sale of CMI's interest. This is referred to as the drag-along provision. Specifically, Article 6.10(a) of the Shareholders Agreement states:

> Notwithstanding the other provisions of this Article 6, if an Insolvency Event occurs in respect of CanWest and is continuing, the GS Parties shall be entitled to sell all of their Shares to any *bona fide* Arm's Length third party or parties at a

> price and on other terms and conditions negotiated by GSCP in its discretion provided that such third party or parties acquires all of the Shares held by the CanWest Parties at the same price and on the same terms and conditions, and in such event, the CanWest Parties shall sell their Shares to such third party or parties at such price and on such terms and conditions. The Corporation and the CanWest Parties each agree to cooperate with and assist GSCP with the sale process (including by providing protected purchasers designated by GSCP with confidential information regarding the Corporation (subject to a customary confidentiality agreement) and with access to management).

8 The Agreement also provided that 441 as shareholder could transfer its CW Investments Co. shares to its parent, CMI, at any time, by gift, assignment or otherwise, whether or not for value. While another specified entity could not be dissolved, no prohibition was placed on the dissolution of 441. 441 had certain voting obligations that were to be carried out at the direction of CMI. Furthermore, CMI was responsible for ensuring the performance by 441 of its obligations under the Shareholders Agreement.

9 On October 5, 2009, pursuant to a Dissolution Agreement between 441 and CMI and as part of the winding-up and distribution of its property, 441 transferred all of its property, namely its 352,986 Class A shares and 666 Class B preferred shares of CW Investments Co., to CMI. CMI undertook to pay and discharge all of 441's liabilities and obligations. The material obligations were those contained in the Shareholders Agreement. At the time, 441 and CW Investments Co. were both solvent and CMI was insolvent. 441 was subsequently dissolved.

10 For the purposes of these two motions only, the parties have agreed that the court should assume that the transfer and dissolution of 441 was intended by CMI to provide it with the benefit of all the provisions of the CCAA proceedings in relation to contractual obligations pertaining to those shares. This would presumably include both the stay provisions found in section 11 of the CCAA and the disclaimer provisions in section 32 .

11 The CMI Entities state that CMI's interest in the Specialty TV Business is critical to the restructuring and recapitalization prospects of the CMI Entities and that if the GS parties were able to effect a sale of CW Investments Co. at this time, and on terms that suit them, it would be disastrous to the CMI Entities and their stakeholders. Even the overhanging threat of such a sale is adversely affecting the negotiation of a successful restructuring or recapitalization of the CMI Entities.

12 On October 6, 2009, I granted an Initial Order in these proceedings. CW Investments Co. was not an applicant. The CMI Entities requested a stay of proceedings to allow them to proceed to develop a plan of arrangement or compromise to implement a consensual "pre-packaged" recapitalization transaction. The CMI Entities and the Ad Hoc Committee of 8% Noteholders had agreed on terms of such a transaction that were reflected in a support agreement and term sheet.

Those noteholders who support the term sheet have agreed to vote in favour of the plan subject to certain conditions one of which is a requirement that the Shareholders Agreement be amended.

13 The Initial Order included the typical stay of proceedings provisions that are found in the standard form order promulgated by the Commercial List Users Committee. Specifically, the order stated:

> 15. THIS COURT ORDERS that until and including November 5, 2009, or such later date as this Court may order (the "Stay Period"), no proceeding or enforcement process in any court or tribunal (each, a "Proceeding") shall be commenced or continued against or in respect of the CMI Entities, the Monitor or the CMI CRA or affecting the CMI Business or the CMI Property, except with the written consent of the applicable CMI Entity, the Monitor and the CMI CRA (in respect of Proceedings affecting the CMI Entities, the CMI Property or the CMI Business), the CMI CRA (in respect of Proceedings affecting the CMI Entities, the CMI property or the CMI Business), the CMI CRA (in respect of Proceedings affecting the CMI CRA), or with leave of this Court, and any and all Proceedings currently under way against or in respect of the CMI Entities or the CMI CRA or affecting the CMI Business or the CMI Property are hereby stayed and suspended pending further Order of this Court. In the case of the CMI CRA, no Proceeding shall be commenced against the CMI CRA or its directors and officers without prior leave of this Court on seven (7) days notice to Stonecrest Capital Inc.
>
> 16. THIS COURT ORDERS that during the Stay Period, all rights and remedies of any individual, firm, corporation, governmental body or agency, or any other entities (all of the foregoing, collectively being "Persons" and each being a "Person") against or in respect of the CMI Entities, the Monitor and/or the CMI CRA, or affecting the CMI Business or the CMI Property, are hereby stayed and suspended except with the written consent of the applicable CMI Entity, the Monitor and the CMI CRA (in respect of rights and remedies affecting the CMI Entities, the CMI Property or the CMI Business), the CMI CRA (in respect of rights or remedies affecting the CMI CRA), or leave of this Court, provided that nothing in this Order shall (i) empower the CMI Entities to carry on any business which the CMI Entities are not lawfully entitled to carry on, (ii) exempt the CMI Entities from compliance with statutory or regulatory provisions relating to health, safety or the environment, (iii) prevent the filing of any registration to preserve or perfect a security interest, or (iv) prevent the registration of a claim for lien.

14 The GS parties were not given notice of the CCAA application. On November 2, 2009, they brought a motion that, among other things, seeks to set aside the transfer of the shares from 441 to CMI or, in the alternative, require CMI to perform and not disclaim the Shareholders Agreement as

if the shares had not been transferred. On November 10, 2009 the GS parties purported to revive 441 by filing Articles of Revival with the Director of the CBCA. The CMI Entities were not notified nor was any leave of the court sought in this regard. In an amended notice of motion dated November 19, 2009 (the "main motion"), the GS Parties request an order:

(a) Setting aside and declaring void the transfer of the shares from 441 to CMI;
(b) declaring that the rights and remedies of the GS Parties in respect of the obligations of 441 under the Shareholders Agreement are not affected by these CCAA proceedings in any way whatsoever;
(c) in the alternative to (a) and (b), an order directing CMI to perform all of the obligations that bound 441 immediately prior to the transfer;
(d) in the alternative to (a) and (b), an order declaring that the obligations that bound 441 immediately prior to the transfer, may not be disclaimed by CMI pursuant to section 32 of the CCAA or otherwise; and
(e) if necessary, a trial of the issues arising from the foregoing.

15 They also requested an order amending paragraph 59 of the Initial Order but that issue has now been resolved and I am satisfied with the amendment proposed.

16 The CMI Entities then brought a motion on November 24, 2009 for an order that the GS motion is stayed. As in a game of chess, on December 3, 2009, the GS Parties served a cross-motion in which, if required, they seek leave to proceed with their motion.

17 In furtherance of their main motion, the GS Parties have expressed a desire to examine 4 of the 5 members of the Special Committee of the Board of Directors of Canwest. That Committee was constituted, among other things, to oversee the restructuring. The GS Parties have also demanded an extensive list of documentary production. They also seek to impose significant discovery demands upon the senior management of CanWest.

Issues

18 The issues to be determined on these motions are whether the relief requested by the GS Parties in their main motion is stayed based on the Initial Order and if so, whether the stay should be lifted. In addition, should the relief sought in paragraph 1(e) of the main motion be struck.

Positions of Parties

19 In brief, the parties' positions are as follows. The CMI Entities submit that the GS Parties' motion is a "proceeding" that is subject to the stay under paragraph 15 of the Initial Order. In addition, the relief sought by them involves "the exercise of any right or remedy affecting the CMI Business or the CMI Property" which is stayed under paragraph 16 of the Initial Order. The stay is consistent with the purpose of the CCAA. They submit that the subject matter of the motion should

be caught so as to prevent the GS parties from gaining an unfair advantage over other stakeholders of the CMI Entities and to ensure that the resources of the CMI Entities are devoted to developing a viable restructuring plan for the benefit of all stakeholders. They also state that CMI's interest in CW Investments Co. is a significant portion of its enterprise value. They state further that their actions were not in breach of the Shareholders Agreement and in any event, debtor companies are able to organize their affairs in order to benefit from the CCAA stay. Furthermore, any loss suffered by the GS Parties can be quantified.

20 In paragraph 1(e) of the main motion, the GS parties seek to prevent CMI from disclaiming the obligations of 441 that existed immediately prior to the transfer of the shares to CMI. If this relief is not stayed, the CMI Entities submit that it should be struck out pursuant to Rule 25.11(b) and (c) as premature and improper. They also argue that section 32 of the CCAA provides a procedure for disclaimer of agreements which the GS Parties improperly seek to circumvent.

21 Lastly, the CMI Entities state that the bases on which a CCAA stay should be lifted are very limited. Most of the grounds set forth in *Re Canadian Airlines Corp.*[1] which support the lifting of a stay are manifestly inapplicable. As to prejudice, the GS parties are in no worse position than any other stakeholder who is precluded from relying on rights that arise on an insolvency default. In contrast, the prejudice to the CMI Entities would be debilitating and their resources need to be devoted to their restructuring. The GS Parties' rights would not be lost by the passage of time. The GS Parties' motion is all about leverage and a desire to improve the GS Parties' negotiating position submits counsel for the CMI Entities.

22 The Ad Hoc Committee of Noteholders, as mentioned, supports the CMI Entities' position. In examining the context of the dispute, they submit that the Shareholders Agreement permitted and did not prohibit the transfer of 441's shares. Furthermore, the operative obligations in that agreement are obligations of CMI, not 441. It is the substance of the GS Parties' claims and not the form that should govern their ability to pursue them and it is clearly encompassed by the stay. The Committee relies on *Chef Ready Foods Ltd. v. Hongkong Bank of Canada*[2] in support of their position on timing.

23 The Special Committee also supports the CMI Entities. It submits that the primary relief sought by the GS parties is a declaration that their contracts to and with CW Investments cannot or should not be disclaimed. The debate as to whether 441 could properly be assimilated into CMI is no more than an alternate argument as to why such disclaimer can or cannot occur. They state that the subject matter of the GS Parties' motion is premature.

24 The GS Parties submit that the stay does not prevent parties affected by the CCAA proceedings from bringing motions within the CCAA proceedings themselves. The use of CCAA powers and the scope of the stay provided in the Initial Order and whether it applies to the GS Parties' motion are proper questions for the court charged with supervising the CCAA process. They also argue that the motion would facilitate negotiation between key parties, raises the important

preliminary issue of the proper scope and application of section 32 of the CCAA, and avoids putting the Monitor in the impossible position of having to draw legal conclusions as to the scope of CMI's power to disclaim. The court should be concerned with pre-filing conduct including the reason for the share transfer, the timing, and CMI's intentions.

25 Even if the stay is applicable, the GS parties submit that it should be lifted. In this regard, the court should consider the balance of convenience, the relative prejudice to parties, and where relevant, the merits of the proposed action. The court should also consider whether the debtor company has acted and is acting in good faith. The GS Parties were the medium by which the Specialty TV Business became part of Canwest. Here, all that is being sought is a reversal of the false and highly prejudicial start to these restructuring proceedings. It is necessary to take steps now to protect a right that could be lost by the passage of time. The transfer of the shares exhibited bad faith on the part of Canwest. 441 insulated CW Investments Co. and the Specialty TV Business from the insolvency of CMI and thereby protected the contractual rights of the GS Parties. The manifest harm to the GS Parties that invited the motion should be given weight in the court's balancing of prejudices. Concerns as to disruption of the restructuring process could be met by imposing conditions on the lifting of a stay as, for example, the establishment of a timetable.

Discussion

(a) Legal Principles

26 First I will address the legal principles applicable to the granting and lifting of a CCAA stay.

27 The stay provisions in the CCAA are discretionary and are extraordinarily broad. Section 11.02 (1) and (2) states:

> 11.02 (1) 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) 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.

28 The underlying purpose of the court's power to stay proceedings has frequently been described in the case law. It is the engine that drives the broad and flexible statutory scheme of the CCAA: *Re Stelco Inc*[3] and the key element of the CCAA process: *Re Canadian Airlines Corp.*[4] The power to grant the stay is to be interpreted broadly in order to permit the CCAA to accomplish its legislative purpose. As noted in *Re Lehndorff General Partner Ltd.*[5], the power to grant a stay extends to effect the position of a company's secured and unsecured creditors as well as other parties who could potentially jeopardize the success of the restructuring plan and the continuance of the company. As stated by Farley J. in that case,

> "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. ... 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."[6] (Citations omitted)

29 The all encompassing scope of the CCAA is underscored by section 8 of the Act which precludes parties from contracting out of the statute. See *Chef Ready Foods Ltd. v. Hongkong Bank of Canada*[7] in this regard.

30 Two cases dealing with stays merit specific attention. *Campeau v. Olympia & York Developments Ltd.*[8] was a decision granted in the early stages of the evolution of the CCAA. In that case, the plaintiffs brought an action for damages including the loss of share value and loss of opportunity both against a company under CCAA protection and a bank. The statement of claim had been served before the company's CCAA filing. The plaintiff sought to lift the stay to proceed with its action. The bank sought an order staying the action against it pending the disposition of the CCAA proceedings. Blair J. examined the stay power described in the CCAA, section 106 of the Courts of Justice Act[9] and the court's inherent jurisdiction. He refused to lift the stay and granted the stay in favour of the bank until the expiration of the CCAA stay period. Blair J. stated that the plaintiff's claims may be addressed more expeditiously in the CCAA proceeding itself.[10] Presumably this meant through a claims process and a compromise of claims. The CCAA stay

precludes the litigating of claims comparable to the plaintiff's in *Campeau*. If it were otherwise, the stay would have no meaningful impact.

31 The decision of *Chef Ready Foods Ltd. v. Hongkong Bank of Canada* is also germane to the case before me. There, the Bank demanded payment from the debtor company and thereafter the debtor company issued instant trust deeds to qualify for protection under the CCAA. The bank commenced proceedings on debenture security and the next day the company sought relief under the CCAA. The court stayed the bank's enforcement proceedings. The bank appealed the order and asked the appellate court to set aside the stay order insofar as it restrained the bank from exercising its rights under its security. The B.C. Court of Appeal refused to do so having regard to the broad public policy objectives of the CCAA.

32 As with the imposition of a stay, the lifting of a stay is discretionary. There are no statutory guidelines contained in the Act. According to Professor R.H. McLaren in his book "Canadian Commercial Reorganization: Preventing Bankruptcy"[11], an opposing party faces a very heavy onus if it wishes to apply to the court for an order lifting the stay. In determining whether to lift the stay, the court should consider whether there are sound reasons for doing so consistent with the objectives of the CCAA, including a consideration of the balance of convenience, the relative prejudice to parties, and where relevant, the merits of the proposed action: *ICR Commercial Real Estate (Regina) Ltd. v. Bricore Land Group Ltd.*[12]. That decision also indicated that the judge should consider the good faith and due diligence of the debtor company.[13]

33 Professor McLaren enumerates situations in which courts will lift a stay order. The first six were cited by Paperny J. in 2000 in *Re Canadian Airlines Corp.*[14] and Professor McLaren has added three more since then. They are:

1. When the plan is likely to fail.
2. The applicant shows hardship (the hardship must be caused by the stay itself and be independent of any pre-existing condition of the applicant creditor).
3. The applicant shows necessity for payment (where the creditors' financial problems are created by the order or where the failure to pay the creditor would cause it to close and thus jeopardize the debtor's company's existence).
4. The applicant would be significantly prejudiced by refusal to lift the stay and there would be no resulting prejudice to the debtor company or the positions of creditors.
5. It is necessary to permit the applicant to take steps to protect a right which could be lost by the passing of time.
6. After the lapse of a significant time period, the insolvent is no closer to a proposal than at the commencement of the stay period.
7. There is a real risk that a creditor's loan will become unsecured during the stay period.
8. It is necessary to allow the applicant to perfect a right that existed prior to the

commencement of the stay period.

9. It is in the interests of justice to do so.

(b) Application

34 Turning then to an application of all of these legal principles to the facts of the case before me, I will first consider whether the subject matter of the main motion of the GS Parties is captured by the stay and then will address whether the stay should be lifted.

35 In analyzing the applicability of the stay, I must examine the substance of the main motion of the GS Parties and the language of the stay found in paragraphs 15 and 16 of my Initial Order.

36 In essence, the GS Parties' motion seeks to:

(i) undo the transfer of the CW Investments Co. shares from 441 to CMI or

(ii) require CMI to perform and not disclaim the Shareholders Agreement as though the shares had not been transferred.

37 It seems to me that the first issue is caught by the stay of proceedings and the second issue is properly addressed if and when CMI seeks to disclaim the Shareholders Agreement.

38 The substance of the GS Parties' motion is a "proceeding" that is subject to the stay under paragraph 15 of the Initial Order which prohibits the commencement of all proceedings against or in respect of the CMI Entities, or affecting the CMI Business or the CMI Property. The relief sought would also involve "the exercise of any right or remedy affecting the CMI Business or the CMI Property" which is stayed under paragraph 16 of the Initial Order.

39 When one examines the relief requested in detail, the application of the stay is clear. The GS Parties ask first for an order setting aside and declaring void the transfer of the shares from 441. As the shares have been transferred to the CMI Entities presumably pursuant to section 6.5(a) of the Shareholders Agreement, this is relief "affecting the CMI Property". Secondly, the GS Parties ask for a declaration that the rights and remedies of the GS Parties in respect of the obligations of 441 are not affected by the CCAA proceedings. This relief would permit the GS Parties to require CMI to tender the shares for sale pursuant to section 6.10 of the Shareholders Agreement. This too is relief affecting the CMI Entities and the CMI Property. Thirdly, they ask for an order directing CMI to perform all of the obligations that bound 441 prior to the transfer. This represents the exercise of a right or remedy against CMI and would affect the CMI Business and CMI Property in violation of paragraph 16 of the Initial Order. This is also stayed by virtue of paragraph 15. Fourthly, the GS Parties seek an order declaring that the obligations that bound 441 prior to the transfer may not be disclaimed. This both violates paragraph 16 of the Initial Order and also seeks to avoid the express provisions contained in the recent amendments to the CCAA that address disclaimer.

40 Accordingly, the substance and subject matter of the GS Parties' motion are certainly encompassed by the stay. As Mr. Barnes for the CMI Entities submitted, had CMI taken the steps it did six months ago and the GS Parties commenced a lawsuit, the action would have been stayed. Certainly to the extent that the GS Parties are seeking the freedom to exercise their drag along rights, these rights should be captured by the stay.

41 The real question, it seems to me, is whether the stay should be lifted in this case. In considering the request to lift the stay, it is helpful to consider the context and the provisions of the Shareholders Agreement. In his affidavit sworn November 24, 2009, Mr. Strike, the President of Corporate Development & Strategy Implementation of Canwest Global and its Recapitalization Officer, states that the joint acquisition from Alliance Atlantis was intensely and very carefully negotiated by the parties and that the negotiation was extremely complex and difficult. "Every aspect of the deal was carefully scrutinized, including the form, substance and precise terms of the Initial Shareholders Agreement." The Shareholders Agreement was finalized following the CRTC approval hearing. Among other things:

- Article 2.2 (b) provides that CMI is responsible for ensuring the performance by 441 of its obligations under the Shareholders Agreement.
- Article 6.1 contains a restriction on the transfer of shares.
- Article 6.5 addresses permitted transfers. Subsection (a) expressly permits each shareholder to transfer shares to a parent of the shareholder. CMI was the parent of the shareholder, 441.
- Article 6.10 provides that notwithstanding the other provisions of Article 6, if an insolvency event occurs (which includes the commencement of a CCAA proceeding), the GS Parties may sell their shares and cause the Canwest parties to sell their shares on the same terms. This is the drag along provision.
- Article 6.13 prohibits the liquidation or dissolution of another company[15] without the prior written consent of one of the GS Parties[16].

42 The recital of these provisions and the absence of any prohibition against the dissolution of 441 indicate that there is a good arguable case that the Shareholders Agreement, which would inform the reasonable expectations of the parties, permitted the transfer and dissolution.

43 The GS Parties are in no worse position than any other stakeholder who is precluded from relying on rights that arise upon an insolvency default. As stated in *San Francisco Gifts Ltd.*[17]:

> "The Initial Order enjoined all of San Francisco's landlords from enforcing contractual insolvency clauses. This is a common prohibition designed, at least in part, to avoid a creditor frustrating the restructuring by relying on a contractual breach occasioned by the very insolvency that gave rise to proceedings in the first place."[18]

44 Similarly, in *Norcen Energy Resources Ltd.*[19], one of the debtor's joint venture partners in certain petroleum operations was unable to rely on an insolvency clause in an agreement that provided for the immediate replacement of the operator if it became bankrupt or insolvent.

45 If the stay were lifted, the prejudice to CMI would be great and the proceedings contemplated by the GS Parties would be extraordinarily disruptive. The GS Parties have asked to examine 4 of the 5 members of the Special Committee. The Special Committee is a committee of the Board of Directors of Canwest. Its mandate includes, among other things, responsibility for overseeing the implementation of a restructuring with respect to all, or part of the business and/or capital structure of Canwest. The GS Parties have also requested an extensive list of documentary production including all documents considered by the Special Committee and any member of that Committee relating to the matters at issue; all documents considered by the Board of Directors and any member of the Board of Directors relating to the matters at issue; all documents evidencing the deliberations, discussions and decisions of the Special Committee and the Board of Directors relating to the matters at issue; all documents relating to the matters at issue sent to or received by Leonard Asper, Derek Burney, David Drybrough, David Kerr, Richard Leipsic, John Maguire, Margot Micillef, Thomas Strike, and Hap Stephen, the Chief Restructuring Advisor appointed by the court. As stated by Mr. Strike in his affidavit sworn November 24, 2009,

> "The witnesses that the GS Parties propose to examine include the most senior executives of the CMI Entities; those who are most intensely involved in the enormously complex process of achieving a successful going concern restructuring or recapitalization of the CMI Entities. Myself, Mr. Stephen, Mr. Maguire and the others are all working flat out on trying to achieve a successful restructuring or recapitalization of the CMI Entities. Frankly, the last thing we should be doing at this point is preparing for a forensic examination, in minute detail, over events that have taken place over the past several months. At this point in the restructuring/recapitalization process, the proposed examination would be an enormous distraction and would significantly prejudice the CMI Entities' restructuring and recapitalization efforts."

46 While Mr. McElcheran for the GS Parties submits that the examinations and the scope of the examinations could be managed, in my view, the litigating of the subject matter of the motion would undermine the objective of protecting the CMI Entities while they attempt to restructure. The GS Parties continue to own their shares in CW Investments Co. as does CMI. CMI continues to operate the Specialty TV Business. Furthermore, CMI cannot sell the shares without the involvement of the Monitor and the court. None of these facts have changed. The drag along rights are stayed (although as Mr. McElcheran said, it is the cancellation of those rights that the GS Parties are concerned about.)

47 A key issue will be whether the CMI Parties can then disclaim that Agreement or whether they should be required to perform the obligations which previously bound 441. This issue will no doubt

arise if and when the CMI Entities seek to disclaim the Shareholders Agreement. It is premature to address that issue now. Furthermore, section 32 of the CCAA now provides a detailed process for disclaimer. It states:

> 32.(1) Subject to subsections (2) and (3), a debtor company may -- on notice given in the prescribed form and manner to the other parties to the agreement and the monitor -- disclaim or resiliate any agreement to which the company is a party on the day on which proceedings commence under this Act. The company may not give notice unless the monitor approves the proposed disclaimer or resiliation.
>
> (2) Within 15 days after the day on which the company gives notice under subsection (1), a party to the agreement may, on notice to the other parties to the agreement and the monitor, apply to a court for an order that the agreement is not to be disclaimed or resiliated.
>
> (3) If the monitor does not approve the proposed disclaimer or resiliation, the company may, on notice to the other parties to the agreement and the monitor, apply to a court for an order that the agreement be disclaimed or resiliated.
>
> (4) In deciding whether to make the order, the court is to consider, among other things,
>
> (a) whether the monitor approved the proposed disclaimer or resiliation;
>
> (b) whether the disclaimer or resiliation would enhance the prospects of a viable compromise or arrangement being made in respect of the company; and
>
> (c) whether the disclaimer or resiliation would likely cause significant financial hardship to a party to the agreement.

48 Section 32, therefore, provides the scheme and machinery for the disclaimer of an agreement. If the monitor approves the disclaimer, another party may contest it. If the monitor does not approve the disclaimer, permission of the court must be obtained. It seems to me that the issues surrounding any attempt at disclaimer in this case should be canvassed on the basis mandated by Parliament in section 32 of the amended Act.

49 In my view, the balance of convenience, the assessment of relative prejudice and the relevant merits favour the position of the CMI Entities on this lift stay motion. As to the issue of good faith, the question is whether, absent more, one can infer a lack of good faith based on the facts outlined in the materials filed including the agreed upon admission by the CMI Entities. The onus to lift the stay is on the moving party. I decline to exercise my discretion to lift the stay on this basis.

50 Turning then to the factors listed by Professor McLaren, again I am not persuaded that based on the current state of affairs, any of the factors are such that the stay should be lifted. In light of this determination, there is no need to address the motion to strike paragraph 1(e) of the GS Parties' main motion.

51 The stay of proceedings in this case is performing the essential function of keeping stakeholders at bay in order to give the CMI Entities a reasonable opportunity to develop a restructuring plan. The motions of the GS Parties are dismissed (with the exception of that portion dealing with paragraph 59 of the Initial Order which is on consent) and the motion of the CMI Entities is granted with the exception of the strike portion which is moot.

52 The Monitor, reasonably in my view, did not take a position on these motions. Its counsel, Mr. Byers, advised the court that the Monitor was of the view that a commercial resolution was the best way to resolve the GS Parties' issues. It is difficult to disagree with that assessment.

S.E. PEPALL J.

* * * * *

Schedule A

[Editor's note: Schedule A was not attached to the copy received from the Court and therefore is not included in the judgment.]

1 (2000), 19 C.B.R. (4th) 1.

2 [1990] B.C.J. No. 2384 (C.A.) at p. 4.

3 (2005), 75 O.R. (3d) 5 (C.A.) at para. 36.

4 (2000), 19 C.B.R. (4th) 1.

5 (1993), 17 C.B.R. (3d) 24.

6 Ibid, at p. 32.

7 Supra, note 2

8 (1992) 14 C.B.R. (3d) 303.

9 R.S.O. 1990, c. C.43.

10 Supra, note 6 at paras. 24 and 25.

11 (Aurora: Canada Law Book, looseleaf) at para. 3.3400.

12 (2007), 33 C.B.R. (5th) 50 (Sask. C.A.) at para. 68.

13 Ibid, at para. 68.

14 Supra, note 3.

15 This was 4414641 Canada Inc. but not 4414616 Canada Inc., the company in issue before me.

16 Specifically, GS Capital Partners VI Fund, L.P.

17 5 C.B.R. (5th) 92 at para. 37.

18 Ibid, at para. 37.

19 (1988), 72 C.B.R. (N.S.) 1.

TAB 12

Bill Clause No. (Number) 78
Section No. (Number) CCAA (Companies' Creditors Arrangement Act) s. (section)36.1
Topic: *Bankruptcy and Insolvency Act* Provisions

Proposed Wording

36.1(1) Sections 38 and 95 to 101 of the *Bankruptcy and Insolvency Act* apply, with any modifications that the circumstances require, in respect of a compromise or arrangement unless the compromise or arrangement provides otherwise.

(2) For the purposes of subsection (1), a reference in sections 38 and 95 to 101 of the *Bankruptcy and Insolvency Act*

> **(*a*) to "date of the bankruptcy" is to be read as a reference to "day on which proceedings commence under this Act";**
>
> **(*b*) to "trustee" is to be read as a reference to "monitor"; and**
>
> **(*c*) to "bankrupt", "insolvent person" or "debtor" is to be read as a reference to "debtor company".**

Rationale

Subsection (1) is added in order to ensure that the provisions of the BIA (Bankruptcy and Insolvency Act) relating to preferences and transfer at undervalue would apply in CCAA (Companies' Creditors Arrangement Act) matters. The purpose is to prevent forum shopping, where the debtor would choose the CCAA (Companies' Creditors Arrangement Act) because preferences and transfer at undervalue transactions could not be attacked.

Subsection (2) is added to provide clarification that the BIA (Bankruptcy and Insolvency Act) terminology is to be read in the CCAA (Companies' Creditors Arrangement Act) context.

Present Law

None.

IN THE MATTER OF THE COMPANIES' CREDITORS ARRANGEMENT ACT, R.S.C. 1985, c. C-36, AS AMENDED

Court File No.: CV-17-11846-00CL

AND IN THE MATTER OF A PLAN OF COMPROMISE OR ARRANGEMENT OF SEARS CANADA INC., et al.

ONTARIO
SUPERIOR COURT OF JUSTICE
(COMMERCIAL LIST)

Proceeding commenced at TORONTO

BOOK OF AUTHORITIES OF THE MONITOR
(Transfer Undervalue Claim Approval)
(returnable December 3, 2018)

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